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War or peace in Iraq?
PAGES 43 AND 84

Israel's Gaza pull-out
PAGES 12 AND 25-27

How companies innovate
PAGES 11 AND 71-73

Asia's democratic miracle
PAGES 10 AND 39

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Leaders
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United States
The Americas
Asia
Middle East & Africa
Europe
Britain
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Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

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Mobile Edition
RSS Feeds

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Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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Interest rates
The end of cheap money

Democracy in Asia
That other miracle

Companies and innovation
Less glamour, more profit

The European Union's constitutional treaty
The voters' charter

Israel and the Palestinians
Gaza isn't the end of it

Royal Dutch/Shell
Humiliation

Letters
On retirement, pay, gay divorce, torpedoes, al-Qaeda, religion, architecture

Special Report
Israel and Palestine
Has something really changed?

Israel's nukes
Vanunu's story

United States
The economy
And for my next trick

New York cabs
Taken for a ride?

Arnold Schwarzenegger
Easy stuff, government

The electoral week
On the trail

Sierra Club elections
Rock the vote

Guantánamo Bay and the Supreme Court
A lawless enclave?

Mid-western casinos
Taking chances

Lexington
The warrior president

The Americas
Argentina's energy shortage
The laws of economics bite back

Peru's coca farmers
Always coca

Haiti
After the fall

Ecuador
Not so loco

Asia
Indonesia
Ready for the big one

South Korea
The comeback kid

China and North Korea
Heads together

The Philippines
The star and the economist

Business
Royal Dutch/Shell
Sick and tired about lying

Biodefence
Drug problem

Russian oil
Freezing to death

Business in China
D'Long caught short

The porn industry
Debbie doesn't do Dallas

The newspaper industry
Yesterday's papers

Bad service
A complaint is a gift

Low-cost airlines
Crowded skies

Face value
The Big Mac succession

Special Report
Business innovation
Don't laugh at gilded butterflies

Finance & Economics
Financial markets
When rates rise

Brazil and the markets
Doubting Lula

Japan's economy
The final piece

Private equity
Barbarians at the stockmarket

Insuring the Olympics
Uncovered

Wall Street's trials
Mixed opinions

Economics focus
The price of peace

Science & Technology
Sports anthropology
Take me out to the ballgame

Genetics
Of mice, and not men

Medicine
An affair of the heart

Climate change
Plumbing the depths

Astronomy
Dark side of the moon

Books & Arts
Bob Woodward on Iraq
All another president's men

American foreign policy
Have strategy, need tactics

Doing business in China
The perils of Pat

India's election
In the name of the father

Pakistan's tenacious president
Third time lucky?

Middle East & Africa

Iraq
Is it war, or peace?

Saudi Arabia
Bin Laden hates Saudis, too

Iranian influence in Iraq
Tetchy neighbours

People-trafficking from Nigeria
Nigeria's other export

Europe

Spain's new government
Waking up to reality

Hungary and the Holocaust
The past reassessed

The Yugoslav war-crimes tribunal
By no other name

Slovakia
The not-so-bad man wins

Italian politics
Bossi's boots

The German-Polish border
A tale of two cities

Charlemagne
Those other referendums

Britain

The BBC
Reining in Auntie

DNA fingerprinting
The sins of the fathers

Theft
Shed pounds with a PA

Migration
Why is Britain moving north?

WH Smith
Bid blood and private equity

Household finances
Debt threat

Dropping out
Child bribe

Bagehot
Plenty of risk, not much reward

Samuel Smiles
On the origin of self-help

Madagascar's natural history
Tales in a twist

Exploration in Africa
Lovers up the Nile

Obituary

Kamisese Mara

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Labour disputes

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Trade in commercial services

Emerging-Market Indicators

Overview

The Economist poll of forecasters

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Politics this week

Apr 22nd 2004
From The Economist print edition

More violence in Iraq

Reuters

Violence continued to afflict **Iraq**. A fragile truce held in the Sunni town of Fallujah, west of Baghdad, but in the previously fairly peaceful southern town of Basra car-bombs killed at least 68 Iraqis. They included many children, as well as police officers who had stayed loyal to the new regime during the current uprising led by the rebel Shia cleric, Muqtada al-Sadr, who remained defiantly holed up in the holy city of Najaf.

See article

Israeli forces killed Abdel Aziz Rantisi, recently chosen as the leader of the Palestinians' Islamist movement, **Hamas**, a month after they had assassinated his predecessor, Sheikh Ahmed Yassin. The action was condemned worldwide, except by America.

A suicide-bomber blew up the headquarters of the security service in **Saudi Arabia's** capital, Riyadh, killing at least four people.

See article

The UN began a probe into its now-discontinued oil-for-food programme for **Iraq** amid allegations of bribery and corruption. Billions of dollars are said to have been pocketed by Saddam Hussein and other Iraqi officials.

Five years after democracy's restoration, **Nigeria's** government said it would finally start publishing details of what happens to its oil revenues.

Lawless land

Lawyers representing prisoners held at **Guantánamo Bay** argued before the Supreme Court that their clients were held in a “lawless enclave” and had a right to be tried. The detainees were mostly captured in Afghanistan, which the Bush administration says makes them “enemy combatants” in a time of war.

See article

America's secretary for homeland security, Tom Ridge, said he was creating a new task force to co-ordinate **anti-terrorism efforts** across federal agencies. Condoleezza Rice said she was taking seriously the possibility that terrorists might try to disrupt the election campaign.

Arnold Schwarzenegger, **California's** governor, signed a new law reforming the workers' compensation programme. The measure, which passed with huge majorities in the state legislature, is expected to help halve the cost of the insurance programme, which had been estimated to cost $30 billion in 2006.

See article

George Bush spent a record $50m during the month of March, most of it on ads attacking his Democratic rival, John Kerry, according to **campaign-finance reports**. However, Mr Kerry raised more money in the first quarter of this year—$60m compared with Mr Bush's $53m.

Tony's U-turn

Britain's prime minister, Tony Blair, reversed course and declared that there would be a referendum on the **EU constitution** after all. The vote is unlikely to come before a general election next year. With most polls showing strong opposition and a largely Eurosceptic press, expectations of a British “yes” are low.

See article

Tempers were raised as it became clearer that the Greek-Cypriots are likely to reject the UN's unification plan for **Cyprus**. The EU's enlargement commissioner, Günter Verheugen, accused the Greek-Cypriot government of obstructing his efforts to make the case for the plan. But attempts to increase the pressure through a new UN Security Council resolution failed when Russia vetoed it.

The European Commission recommended that **Croatia** be invited to open negotiations for EU membership. The Croats promptly said they wanted to join with Romania and Bulgaria in 2007; but EU officials said that a later date was more realistic.

Slovakia's new president is to be Ivan Gasparovic, a populist who unexpectedly beat another populist (and front-runner), Vladimir Meciar, in a run-off election.

See article

Belgian officials announced a further step in the rehabilitation of **Libya's** leader, Muammar Qaddafi. The colonel is to visit Brussels next week, meeting European commissioners as well as the Belgian prime minister.

A big turnout

EPA

The first stage of **India's** general elections began on April 20th relatively peacefully. The country's 670m voters are scheduled to cast their ballots in four stages over three weeks.

See article

North Korea's president, Kim Jong Il, made a secret three-day visit to China. He is believed to have discussed his country's nuclear programme and crumbling economy. China acted as a mediator in the nuclear stand-off, but two rounds of six-party talks have failed to resolve the issue.

See article

The Uri party, which supports **South Korea's** president, Roh Moo-hyun, won a majority in the national assembly. The election was widely seen as a popular verdict on the president's impeachment in March. The constitutional court has to rule on the president's ousting by mid-September.

See article

Golkar, **Indonesia's** former ruling party, selected General Wiranto as its presidential candidate for elections in July. The retired general was indicted for war crimes for his role in the brutal repression of the independence movement in East Timor.

See article

Fresh hopes emerged that **Myanmar's** opposition leader, Aung San Suu Kyi, may soon be released from house arrest. The chairman of her NLD party was set free and the party's headquarters were allowed to reopen a few days earlier. The military junta announced constitutional consultations as part of its “road map to democracy”.

Paramilitary slaying

Carlos Castaño, the leader of the United Self-Defence Forces of **Colombia**, a right-wing paramilitary movement, was attacked by unidentified gunmen. Several of his bodyguards were killed. Mr Castaño's state is unknown.

A UN report found that most **Latin Americans** supported the return of “authoritarian” governments in place of democratic ones. Corruption, inequality and poor economic growth are to blame.

Ricardo Maduro, the president of **Honduras**, announced that the troops his country had sent to Iraq, like Spain's, would be returning home as quickly as possible.

An international arrest warrant was issued for Carlos Menem, the former president of **Argentina**, who is accused of fraudulently using public funds. An Argentine judge turned to Interpol after Mr Menem, who lives in Chile, failed to show up in court for a corruption investigation.

Venezuela's electoral authority said that a referendum on the presidency of Hugo Chávez could be held on August 8th, if the required number of disputed pro-referendum signatures on a petition that called for a vote are validated next month.

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Business this week

Apr 22nd 2004
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It gets worse

Royal Dutch/Shell published a damning independent report into the overstatement of its oil and gas reserves. The oil giant placed the blame firmly on its former chairman, Sir Philip Watts, and another top executive, Walter van de Vijver, for misleading shareholders. Judy Boynton, Shell's finance chief, became the latest boardroom casualty.

See article

Jim Cantalupo, the chairman and chief executive of **McDonalds's** who was called out of retirement to revitalise the burger franchise, died suddenly of a heart attack. In his 15 months in charge, he introduced a new healthier menu to supplement the Big Mac and fries. Charlie Bell, a McDonald's insider, was named as Mr Cantalupo's successor.

See article

Darleen Druyun, a former American air force employee, pleaded guilty to charges that she conspired to award a military-tanker contract to **Boeing**. She admitted discussing a job offer from Boeing while still employed as a procurement official. The contract is suspended while a review is under way.

David Siegel resigned from **US Airways** after two years as boss. Unions refused to countenance another round of job and wage cuts to help the troubled carrier avoid bankruptcy. Mr Siegel had already extracted big concessions to bring the airline out of Chapter 11 protection in 2003.

Settling up

Microsoft's urge to settle lawsuits showed no sign of flagging. The software giant struck a preliminary deal to end a class action by Minnesota's consumers after five weeks on trial for overcharging for its software. Microsoft also offered to extend by two years a key provision of its antitrust settlement with the federal government.

Sanjay Kumar, chairman and chief executive of **Computer Associates**, stepped down after a review by the software company's audit committee into the firm's past accounting practices. However, Mr Kumar will remain at Computer Associates in the newly created position of chief software architect. Nine people were also sacked as a result of an ongoing federal probe of the firm.

MCI came out of Chapter 11 bankruptcy protection after nearly two years. The long-distance telephone company became America's biggest-ever bankrupt when it was known as WorldCom, but now emerges with a new name and in finer financial fettle than many competitors.

Ford's profits overtook analysts' expectations. The car giant made a bumper $1.95 billion in the first quarter, compared with $896m a year ago. **General Motors** also did better than expected, but profits were down by 14% at $1.28 billion.

WH Smith's shares soared after hitting an eight-year low when it emerged that Permira, a private-equity firm, had designs on the ailing British retailer. Permira's offer values WH Smith at some £940m ($1.7 billion).

See article

Novartis and **Aventis**, two drugmakers, agreed to talk about a merger. Franco-German Aventis has spent months fighting off a hostile bid from a smaller French rival, Sanofi-Synthélabo.

Rato's new role

Spain's **Rodrigo Rato** was set to become the next head of the International Monetary Fund after he got the backing of Europe's finance ministers.

Ernst Welteke resigned as chairman of the Bundesbank in the face of controversy over a *euro*7,661 ($9,200) hotel bill paid by Dresdner Bank during the launch of the euro in 2002. In a resignation letter he blasted Germany's government for interfering with the bank's independence by pressuring him to go. Axel Weber, a top academic, will take over.

Mark Whiston stepped down as CEO of **Janus Capital**, one of the first mutual funds to be investigated for improper trading by Eliot Spitzer, New York state's attorney-general. Janus is close to reaching a settlement with regulators over its part in the scandal.

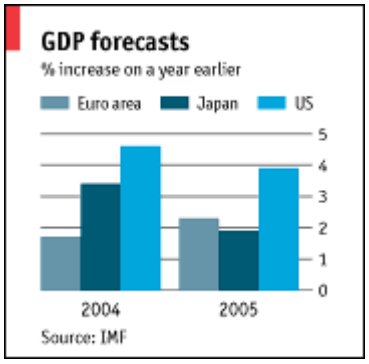
J.P. Morgan Chase reported a big increase in profits—$1.9 billion in the first quarter, 38% more than a year ago. **Bank One**, which J.P. Morgan is buying, reported its biggest-ever quarterly profit of $1.2 billion, 47% higher than a year ago.

Rates must rise

Alan Greenspan, in an address to Congress, said that the threat of deflation was “no longer an issue” and that interest rates would have to rise at some point (though he gave no hint when).

See article

The IMF's *World Economic Outlook* confirmed Mr Greenspan's view. It anticipates that **America's economy** will expand by 4.6% this year and by just under 4% in 2005. Japan's GDP is also set to grow this year by 3.4% but the euro area's economy is destined for growth of below 2% this year.



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Interest rates

The end of cheap money

Apr 22nd 2004
From The Economist print edition

Interest rates will soon have to rise in America, just as they already have in Britain and Australia

MONEY has never been so cheap and so easy to obtain. The average of short-term interest rates in America, Japan and Europe is at its lowest in recorded history—much to the delight of households and firms which have borrowed with wild abandon. America's Federal Reserve and other central banks slashed interest rates after the stockmarket bubble burst in 2000 because of concerns about deflation. But now the world economy looks much healthier than a year ago, so does it need such low interest rates?

There are many signs that inflation is on the rise again. In March America's core rate of consumer-price inflation (excluding energy and food) unexpectedly jumped to 1.6%, from a low of 1.1% in January. As Japan's economy has strongly rebounded, its deflationary pressures have eased: in the year to February, consumer prices were no longer falling and producer prices rose for the first time for almost four years. In the euro area, inflation is starting to edge up again. In China, which was suffering from deflation little more than a year ago, inflation has risen to 3% and many economists expect it to exceed 5% before the end of the year. China is now exporting inflation rather than deflation, as its rapid growth (officially 10% over the past year) and insatiable demand for raw materials have pushed up commodity prices worldwide.

Indeed, the entire world economy looks much livelier. Global GDP growth averaged nearly 6% at an annual rate in the second half of 2003, its fastest pace since 1999, and the International Monetary Fund has revised its forecast for growth this year upwards to a robust 4.6%. In America, consumers continue to spend as freely as ever. Retail sales soared by 9% in the year to the first quarter. And a big jump in employment in March may mean that firms are at last starting to create new jobs. Despite this, fewer jobs have been created in the current recovery than in any other since the 1930s. Even so, deflation no longer seems to be a serious risk, as Alan Greenspan, chairman of the Federal Reserve, acknowledged in testimony to Congress this week (see article). The chance of a rise in American inflation is now probably higher.

A sign of success

If so, the decline in the global inflation rate may be at an end. Almost 25 years ago, when America's inflation was into double digits, Paul Volcker, Mr Greenspan's predecessor, announced his “Saturday Night Special”, a package of measures designed to curb inflation. That was a defining moment, and inflation peaked soon afterwards. Is another turning point in world inflation, but in the opposite direction, about to occur?

Higher inflation is precisely what the Fed and the Bank of Japan have been trying to achieve over the past year. At the start of this year, the average core inflation rate in the G7 economies was only 1%—too low for comfort. Most central bankers would prefer an inflation rate closer to 2%. But hold on. Isn't inflation supposed to be bad? Not necessarily. A little bit more now should insure against a downward spiral of prices, which can be even more damaging than an upward spiral. Moreover, inflation seems unlikely to soar dangerously out of control, because most developed economies still have plenty of spare factory capacity and unemployment. In America, thanks to rapid productivity gains and moderate pay rises, unit labour costs are falling. Excess global capacity will also continue to weigh on the prices of

manufactured goods. It is thus premature to start fretting about a new era of high inflation.

On the other hand, the Fed's position at its last policy meeting—that it can afford to “be patient in removing its policy accommodation”—now looks complacent. Even without the prospect of an immediate inflationary threat, it is time for the Fed to start lifting interest rates. Many argue that there is no need for the Fed to tighten monetary policy until over-capacity in America shrinks. That economic slack is indeed a reason why policy needs to stay fairly loose. But by some measures monetary conditions are currently at their loosest since the mid 1970s when inflation took off. So even a rise in interest rates would still leave monetary policy very loose.

Don't mention the B word

Financial markets now expect the Fed to start raising rates this summer. Some Fed officials, however, still think that they should hold off until consumer-price inflation itself rises further. That would be a mistake. The liquidity that the Fed is pumping out is spilling largely into asset prices instead of conventional inflation, and that can be just as dangerous. Around the globe cheap money has encouraged excessive borrowing and speculation in housing and bonds (see article). Consumers are stretching themselves with bigger mortgages and car loans. House prices have been pushed to record highs in relation to incomes and rents in many countries, including America, Britain, Australia and Spain. The build-up of debt leaves economies vulnerable to a sharp fall in house prices or a rise in interest rates. Such concerns have been one reason why both the Bank of England and the Reserve Bank of Australia have raised interest rates recently.

America's super-loose monetary policy is fuelling potential bubbles abroad as well as at home. Around the globe, speculators are borrowing cheap dollars and investing the proceeds in higher-yielding bonds in Brazil or South Africa, or in property in Shanghai. In Asia heavy foreign-exchange intervention by central banks to hold down their currencies against the dollar have left economies overflowing with liquidity. This is why inflation is rising throughout Asia. The obvious solution is for these governments to allow their currencies to rise. Until they do so, the distorting effects of America's super-lax monetary policy will be magnified around the world.

It is time for the Fed to pull back on the throttle. A modest rise in rates now may dent economic growth in the short term. But the longer the Fed leaves rates so low, the greater the risk that a further surge in asset prices and debt will cause a nasty crash in the future. If that happens, then America's current low rate of inflation could tip into dangerous deflation—the very thing the Fed was trying to avoid.

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Democracy in Asia

That other miracle

Apr 22nd 2004
From The Economist print edition

In this year of elections, Asia is marching towards freedom and democratic maturity

WHEN westerners think of Asia, they mostly think of dollar signs. And with good reason. Call them tigers or dragons, write of thunder in the east or a shining India: whichever image you prefer, the Asian economic miracle is exactly that. Across half the world, in a few short decades, hundreds of millions of people have been lifted out of abject poverty by a combination of hard work, good policies and the benefits of open trade. Yes, there have been problems—remember the Asian financial crisis?—but the truly remarkable thing is how quickly most of the Asian economies have bounced back from them. This year, yet again, it is in Asia that the world's fastest-growing economies are to be found.

Less noticed is Asia's political miracle. But look back 20 years, and barely anywhere in East Asia had democracy taken root. Look now and, with the admittedly huge exception of China and its smaller fellow communist despotisms in Indochina and North Korea, even the most newly planted democracies are thriving. There is a great swathe of democracy in Asia's east, from Japan in the north down to Indonesia in the south. Add in Australasia, which has been democratic for far longer, and the long-standing democracies of South Asia, proudly headed by India which went to the polls this week to elect its 14th parliament, and marvel at a continent of billions, united in their right to choose those who will govern them, and then toss them out again.

Indeed, 2004 is Asia's year of elections. There already have been or will shortly be national ballots in Taiwan, Indonesia, South Korea, the Philippines, Malaysia, Sri Lanka, India and Japan. The first four of those countries were dictatorships of varying shades of nastiness two decades ago. In the case of the last two longer-standing democracies on the list, even there the right of choice has been greatly extended, because the monopoly of power once held by the Congress party in India and the Liberal Democratic Party in Japan has been smashed in the former and significantly eroded in the latter. Even in Indochina, there has been progress of sorts: Cambodia has just had its third, if far from perfect, election.

If democracy ever changed anything, they'd abolish it, say the cynics. Asia's democracies, new and old, need to answer that charge. It is no good kicking out dictators or communist apparatchiks merely to replace them with corrupt capitalists who offer voters no real choice. But the most encouraging thing about Asia's democratic spring is the extent to which the voters are delivering tough messages to their rulers: punishing extremism, corruption and petty politicking.

Indonesia is one bright example. With most of the results now in from the parliamentary election held on April 5th, voters have judged both main parties harshly. President Megawati Sukarnoputri's party has suffered for its drift and lack of focus; but Golkar, the old pro-army party that is the best-organised political force in the country, has failed to make the expected breakthrough (see article). The fact that it was led by Akbar Tandjung, once convicted of corruption though cleared on appeal, was surely a handicap. Weirdly, Golkar has now replaced him as its candidate for July's presidential election with a general, Wiranto, accused of having committed war crimes in East Timor, who is, sadly, fairly popular. But an evidently frustrated electorate has enthusiastically endorsed a new party led by Susilo Bambang Yudhoyono, giving him a much better shot at the top job. This is heady stuff in a country whose democracy is only five years old.

Indonesia's voters have also delivered their verdict on political Islam, shunning all but the most moderate Islamic parties in an open contest—and broadly preferring secular parties over those who seek to mix

God and earthly governance. Even its relatively doctrinaire Prosperous Justice Party, which tripled its share of the vote, emphasised clean government, not Islam. Much the same lesson was delivered in Malaysia last month: PAS, the Islamic opposition, was thrown into retreat by a ruling party that, under pressure of the ballot box, has attempted to clean up its act. That same message of moderation is being heard in India, where the fading appeal of Hindu bigotry has led the ruling BJP to downplay appeals to religion.

Nor do voters much like political stunts. In South Korea and in Taiwan they have punished opposition parties who have tried, on flimsy grounds, to remove elected presidents. Taiwan's Chen Shui-bian was re-elected with a sharply increased vote on March 20th (the opposition are disputing the result, which will do their standing no good at all). In South Korea, attempts to remove Roh Moo-hyun have backfired catastrophically: a brand-new party loyal to Mr Roh has seized a majority in the country's parliament (see article). Both Mr Chen and Mr Roh represent a new generation of politicians, and it now looks as though voters who last time round hedged their bets, by saddling them with parliaments dominated by establishment opposition parties, have decided to trust the rebels and force the old guard to reinvent themselves.

Nothing is perfect

Can democracies always be counted on to make good choices? Of course not. The Philippines, also at the polls next month, chose an appalling president in the shape of Joseph Estrada in 1998, and this time may well elect another, even less qualified, former film star. Sri Lanka may just have scuppered its best hope of peace with the Tamil Tigers, by voting on bread-and-butter, not war-and-peace issues. But the democracies' record, on almost any issue, is surely better than that of undemocratic Vietnam, Laos, North Korea and Myanmar.

Yet it is an inescapable fact that the biggest of the recent Asian success stories is China—where political transformation has yet even to be contemplated. China, of course, is still much poorer than were the other East Asian countries when they started to throw off autocracy in the mid-1980s. And even China is not wholly immune to pluralistic stirrings. Its leaders feel the need to explain themselves more than they used to, while the press has a growing bite, as long as it avoids criticising the high-ups. Asia's political miracle is a work still in progress—but progressing it is.

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Companies and innovation

Less glamour, more profit

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Innovation is rarely rocket science

WHEN Frito-Lay added a little curl to its snacks, the company's sales improved. The clever twist allowed consumers to scoop up their guacamole or salsa dip and place relatively more of it in their mouths and less on their rugs. Of such seemingly modest innovations are great fortunes made. Next month Gillette will launch the successor to its sensationally successful Mach3 razor. Much as the company would like it to be as revolutionary as the Mach3 was in its day, the battery-operated vibrating beard-remover is unlikely to be more than evolutionary. That may not, however, prevent it from making a sizeable contribution to Gillette's profits.

Big firms still aspire to make truly great breakthrough inventions—products that will underwrite their profits for at least a decade. They are, however, coming up with such inventions less and less often, even though many industries, notably pharmaceuticals, continue to spend vast sums trying. Indeed, for most of industrial history, small firms have been responsible for the bulk of breakthrough products. America's Small Business Administration claims that the pacemaker, the personal computer, the Polaroid camera and pre-stressed concrete all emerged from small entrepreneurial outfits, and those are taken only from the list of items beginning with the letter P.

Big firms are better at less eye-catching forms of innovation—adding the twist to the snackfood, for example, and generally improving the ways in which products invented elsewhere are manufactured, marketed and continually enhanced (see article). Henry Ford, whose name is almost synonymous with four-wheeled transport, did not invent the automobile. He “merely” invented a far superior way to manufacture it—namely, the mass-production assembly line. And on that was built an industrial empire that has thrived for almost a century. Likewise, in the past few decades most of the companies that have created truly extraordinary amounts of wealth have done so by inventing great processes, not great products. Dell, Toyota and Wal-Mart, for example, have risen to the top of their respective industries by coming up with amazingly efficient ways of getting quite ordinary products into the hands of consumers more cheaply than their rivals.

Does this mean that big firms should sack all their scientists and leave inventing to others? In practice, more and more are doing just that. For some time, the computer industry has, in effect, relied for much of its research and development on small firms backed by venture capital, and the telecoms industry is outsourcing more and more research to smaller firms in India and elsewhere. Without their own in-house labs, however, big firms fear that they will be taken by surprise by what a Harvard professor, Clayton Christensen, famously described as a “disruptive technology”, an innovation so revolutionary that it will enable an upstart outsider to crush them, much as the PC did to the mainframe-computer business.

But, as history has shown time and time again, a bevy of in-house scientists gives no guarantee that their output will protect their employer from technological change. Xerox, AT&T and IBM spent billions on research but all failed to exploit much of what came out of their labs, and all ended up being caught out by new technologies. It is far better if big firms' managers keep their binoculars well trained on the outside world and their minds open to any new ideas they spot there. They can then buy them and do what they do best: find innovative ways to bring them to market.

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The European Union's constitutional treaty

The voters' charter

Apr 22nd 2004
From The Economist print edition

Why Tony Blair is right to propose a national referendum on the draft EU constitution

Get article background

AFP

FOR a prime minister who professes to have no reverse gear, it was quite some reverse. After months of rejecting the idea, Tony Blair conceded this week that British voters should have the final say over whether to adopt the new European Union constitution that heads of government hope to agree in June. Britain thus joins a growing list of countries—the Czech Republic, Denmark, Ireland, Luxembourg, the Netherlands, Portugal, Spain (almost certainly), Poland (probably) and, after Mr Blair's move, maybe France as well—in putting the document to a popular vote (see article).

Mr Blair's *volte-face* mainly reflected grubby domestic politics (see article). In 1975 a previous Labour government, also for domestic reasons, held a referendum to approve its "renegotiated" terms of accession; but no European treaty has ever been put to the vote in Britain, including the Single European Act of 1986 and the Maastricht treaty of 1992, both of which took big lurches towards greater integration. A British referendum increases the risk that the constitution (more properly called a constitutional treaty) may never come into force. But it is right to hold one, for two main reasons.

The first is that there is still time to improve the text. This is not just a matter of delivering Mr Blair's "red lines", such as preserving national vetoes on tax, social security, foreign policy and defence, even though these remain crucial. Just as important, encroachment into areas of criminal and civil law ought to be curtailed, and made subject to unanimous vote; and the idea of a European public prosecutor should be dropped. It would be desirable, too, to junk the verbose Charter of Fundamental Rights—though it may be hard to persuade others to accept this—for it risks inviting, or even obliging, the European Court of Justice to act as an integrationist force.

But the biggest area for improvement should be "subsidiarity", an ugly term for the proposition that powers are best exercised at the level closest to the citizen. Last year *The Economist* lamented the draft treaty as an opportunity missed: to simplify the hotch-potch of arrangements governing the European Union; to present a shorter constitution that would be easily intelligible to the layman; and, above all, to clarify and settle the balance of powers between the centre and member governments. It is in this last area that the constitution's provisions need most strengthening. One promising idea floating around is to add a "red flag", whereby if one-third of national parliaments, say, object to a legislative proposal because it encroaches on their powers, it must be withdrawn.

People power

Europhiles have often argued against a referendum on the EU constitution because—like the European project in general—it seems so unloved. In brute terms, they fear that it will be rejected. But this is in fact the second reason why a referendum is a good idea. For a big factor contributing to popular disillusion with the EU, which is felt well beyond Britain, is that a huge gulf has opened between what is seen as an elite project run from Brussels and the day-to-day concerns of ordinary voters. And the best way to try to bridge that gulf is to stage a full-blown campaign that gets voters to focus on European

issues—and then decide whether they want the constitution that the Brussels elite is proposing.

What happens if they say no? Nobody knows for sure. In legal terms, the new constitution, like all EU treaties, must be ratified by all member countries (including ten new ones joining next month) before it can come into force; a rejection in one country, whether Britain or somewhere else, is enough to stop it in its tracks. But the experience of Denmark and Ireland, both of which voted to reject previous treaties, suggests that a more likely outcome is that, after minor titivations, a single naysayer would be asked to vote again. If, however, the naysayer is big or recalcitrant, or if several countries say no, it is more likely that the entire constitutional treaty will fall.

Eurosceptics who have been baying for a referendum would doubtless welcome that. But voters may also learn during the campaign that this is unlikely to be the end of the matter. The countries that want more European federalism might go ahead without those that prefer to entrench the European project as solely inter-governmental—especially if the main or only foot-dragger is Britain. It is thus possible that the endgame will be one in which the foot-draggers have to choose whether they want to be in or out of the EU. And it is precisely because the stakes could be this high that it is right to put the constitution to a referendum.

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Israel and the Palestinians

Gaza isn't the end of it

Apr 22nd 2004
From The Economist print edition

What is good for Israel need not be bad for the Palestinians

Get article background

AFP

ARIEL SHARON is a hard man to warm to. The Israeli prime minister whom George Bush called “a man of peace” is heartily loathed by all Arab and much European opinion. And he hardly endears himself to those who loathe him when he orders his army to assassinate Israel's enemies. Last weekend's killing of the new leader of Hamas, Abdel Aziz Rantisi, just after that of his predecessor, Sheikh Ahmed Yassin, has been condemned by almost every government (except America's) not only as unlawful but also as counter-productive. When will the Israelis learn that meeting Palestinian violence with more violence, instead of sitting down to talk, simply feeds the famous “cycle of violence”?

The short answer to that question is: wrong question. It would be splendid if Israel and the Palestinians sat down to talk. But they talked for the best part of the 1990s without making peace. Since the collapse of Bill Clinton's Camp David summit in 2000, and the Palestinian *intifada* that followed, none of the attempts to resume the diplomacy—the Mitchell plan, the Tenet plan, the Zinni plan or the “road map”—has produced so much as a ceasefire. As for that cycle of violence, Hamas tries as hard as possible, every day, to kill as many Israelis as it can. It will doubtless now strive for something spectacular to show that it is still in business. But in the meantime Mr Sharon can justly claim that his tough measures are working: the number of Israelis killed in 2003 fell by a half compared with the year before.

This is the deadlock against which to judge Mr Bush's decision to endorse Mr Sharon's plan to withdraw unilaterally from the Gaza strip. As critics say, quitting Gaza is no substitute for a full, negotiated peace. But not even Mr Sharon, and certainly not the Americans, claim that it is. The plan's whole merit is that it enables something useful to happen at a time when negotiation seems out of reach.

Naturally, Mr Sharon would not leave Gaza unless this was in Israel's own interest: getting out will relieve it of a military and demographic burden. But what is good for Israel does not have to be bad for the Palestinians. Those in Gaza will benefit immediately, provided a decent regime takes over when the Israelis leave. As for the West Bank, the withdrawal sets a precedent. The Likud party's super-hawk, who swore to keep hold of every sacred inch, will have acknowledged that the old dream of a Greater Israel has to be modified—something that has already infuriated Israel's settler movement.

Israel's exit from Gaza is a prize worth having. But did George Bush pay too high a price for it when he reassured Israel last week that, when the time does come to negotiate a final peace, America will not expect Israel to make a “full and complete” withdrawal to its pre-1967 borders or take back the Palestinian refugees of 1948? In fact, no serious peacemaking has ever assumed that Israel would do either of these things. Moreover, Mr Bush's assurances have helped Mr Sharon's chances of talking round his right wing before the Likud votes on the Gaza exodus on May 2nd. The downside is that the president's remarks, by seeming to undermine America's honest-broker role, have damaged America's relations both with its partners in the Middle East “quartet” (Russia, the European Union and the United Nations) and with friendly Arab regimes such as Jordan and, especially, Egypt, whose co-operation will be needed to make an independent Gaza work.

Help the Palestinians too

To restore needed balance, Mr Bush would therefore be wise (though best to wait until after the Likud referendum) to offer some countervailing reassurances to the Palestinians. On refugees, he could say that help will be available for them to settle in the new Palestine and in third countries, with compensation for those who cannot return home. On borders, he could publicly adopt the Camp David idea of land swaps to compensate for whatever settlement blocks Israel is ultimately allowed to keep in the West Bank.

Meanwhile, there is little point in Mr Sharon's critics in Europe and the Arab world repeating the mantra that America must put strong pressure on Israel to change its ways. Neither George Bush nor John Kerry, for that matter, buys the assumption that Mr Sharon, whose policies are widely supported in Israel, is the chief villain of the piece. In the American mind, it is Yasser Arafat, who condemns suicide bombings out of one side of his mouth while extolling “our glorious *intifada*” out of the other, who is truly incorrigible. With no end to the *intifada* in sight, Gaza first is the best plan in town.

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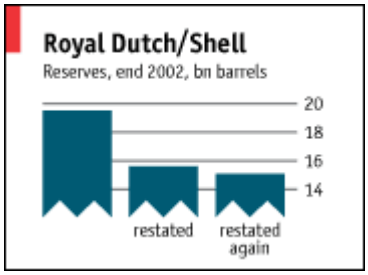
Royal Dutch/Shell

Humiliation

Apr 22nd 2004
From The Economist print edition

A once proud firm, brought down by its own flaws, needs a thorough shake-up



IT IS the corporate equivalent of a Shakespearean tragedy. For more than a century, Royal Dutch/Shell was one of the proudest and most admired companies in the world. Famous for its long-term planning, its technical skills and its collegial management style, Shell also once served as a model of the successful multinational, with its far-flung operations, Anglo-Dutch heritage and twin board structure. Its old corporate slogan, "You can be sure of Shell", seemed a mere statement of fact. Now it seems as if the opposite is the case. Portions of an internal report published this week into the company's restatement of its "proved" oil and gas reserves, first announced in January, reveal that Shell's two top managers spent years arguing about how and whether to lie to investors (see article).

Faith in Shell's management had been badly shaken by the earlier restatement of proved reserves, a key measure of how much oil and gas a company can get to market quickly. But this week's gale of bad news has shattered the firm's credibility: a third restatement of reserves in four months, downgrades of its debt by leading credit agencies, and the resignation of its chief financial officer. Yet the biggest blow of all was the publication of the internal report. "I am becoming sick and tired about lying", the striking phrase in an internal e-mail from Shell's second-ranking executive to its top-ranking one, has been broadcast to the wide world, and will now be associated with the company's name for years to come.

The report, a summary of a much larger document, describes the growing quarrel between Walter van de Vijver, the head of exploration and production, and Sir Philip Watts, the company's executive chairman, who had held Mr Van de Vijver's job before ascending to the top post in July 2001. What seems to have happened is that Mr Van de Vijver realised the reserve figures that he had inherited from Sir Philip were grossly inflated and unsustainable. So he complained to Sir Philip, a strong-willed boss whose reputation for finding and booking new reserves had helped him to climb to the top.

Sir Philip's response was to tell Mr Van de Vijver not only to maintain the existing reserve figures, but to do everything to increase them. The report makes clear that both men knew that the figures which they were presenting to the public were wrong, that those figures did not comply with the regulations of America's Securities and Exchange Commission (SEC), and that such deception mattered a great deal. Mr Van de Vijver may have grown "sick and tired" of lying, but fatigue alone did not stop him. At one point he even ordered an internal memo, warning that Shell was breaking the law, to be destroyed.

Both men resigned in early March and, like Shell itself, now face the prospect of shareholder lawsuits, and civil and criminal investigations. In one sense, the company's response to this crisis deserves praise. It published this week's damning report, and has finally instituted the kind of internal audits of reserves which some oil firms have used for years.

Shame and necessity

But in another sense, the reaction of Shell's existing management should still alarm its shareholders. It has tried to pin most of the blame on Sir Philip and Mr Van de Vijver. But its own internal report paints a much grimmer picture of complacency throughout its top management, which was told about growing problems with reserves, but chose not to enquire into them. Inertia and deference to the boss smothered debate at what was supposed to be one of the world's most thoughtful companies. Even formerly high-placed Shell insiders describe an inward-looking, conceited company which did not believe that complying

with SEC rules should really matter.

Shell now needs a thorough overhaul. It remains financially healthy, despite the blows it has suffered, but it urgently needs to restore the faith of investors, and its credibility with regulators. Its separate British and Dutch boards of directors, now a cumbersome anachronism, must be combined into a single board to clarify lines of accountability, especially through a strong, independent chairman. That person must require Sir Philip's successor, Jeroen van der Veer, to change Shell's arrogant and inward-looking ways. And if he can't, or won't, an outsider will have to be brought in instead.

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About sponsorship

Letters

Apr 22nd 2004
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Retired hurt

SIR – People should work longer, according to your survey of retirement (March 27th). Fine. Just tell us how to do it. In Austria, companies want highly qualified people between 25 and 35 with degrees, experience abroad, available 24 hours a day, mobile and flexible and with no expectations of job security, implying no family ties and no children—and "dynamic" at that. Just try finding a job once you have passed 40. It is time to revise your starry-eyed and near-religious belief in the beneficial and self-regulating forces of the market.

Susanne Lenhart
Vienna

SIR – Your proposal of a tax-free income for those willing to work past the age of 65 would go a long way towards keeping skilled people in the workforce while delaying the need to pay out on pension plans. This might be particularly useful in nations where increasingly high levels of education delay entry into the workforce. Many cannot spend enough time working to accumulate a full pension.

By allowing people to work longer, payments into the pension scheme would continue to accrue to the benefit of eventual retirees while delayed payments—and fewer years of pension paid out—would benefit society as a whole. Sign me up.

Ken Friedman
Oslo

SIR – Your survey is interestingly juxtaposed with another article on obesity in the same issue ("A staple in time…", March 27th). Will not the increase in obesity begin to reduce life expectancy? Even more controversially, obese people tend to be poorer and therefore have a greater dependency on the state, rather than private schemes, for their old-age pension. Thus, growing obesity may well get governments out of their pension crisis.

Joe Carr
London

A question of pay

SIR – As an employer in a domestic plant, I find illogical the theory that workers demand higher wages from multinational-plant owners merely to compensate them for increased job instability (Economics focus, March 27th). A more convincing explanation is that multinational employers pay higher wages than domestic employers to attract and retain better workers, thus reducing the risks of operating in a foreign environment. Having better workers would also serve to explain, in part, why multinationals tend to run their plants more efficiently than domestic firms.

Robert Johnsen
West New York, New Jersey

The gay divorcees

SIR – You say that California's divorce courts could hear cases involving gay couples if the state legalises homosexual marriage ("Lawyers' delight", April 3rd). In fact, the state's law was amended last year to require that domestic partnerships are dissolved using the divorce-court system. Under the amended law, domestic partnerships are identical to marriages except in name and the application of the tax law. Thus, gay divorce will happen here whether gay marriage is legalised or not.

Robert West
San Mateo, California

Ramming home the point

SIR – You say of the Confederate submarine *Hunley* that it "shot" a torpedo into the hull of the *Housatonic* in 1864 ("Dredged from the deep", April 10th). At that time, "torpedo" simply meant an explosive charge used at sea. During the American civil war, torpedoes were commonly attached to poles. Your picture of the *Hunley* clearly shows the pole with which it rammed the *Housatonic* projecting forward from its bow. The first practical self-propelled naval torpedo was invented in 1866 by Robert Whitehead, under contract to the Austrian navy.

Gareth Penn
Greenbrae, California

Ignoring the threat?

SIR – You state the following concerning Richard Clarke's claim that Condoleezza Rice acted as if she had not heard of al-Qaeda: "in fact she had given speeches about the threat of al-Qaeda long before" ("A matter of trust", April 3rd). This claim of prescience about al-Qaeda has been widely broadcast by the Bush administration. However, the only evidence is a set of remarks Ms Rice made about Osama bin Laden. Knowledge of Mr bin Laden is quite different from recognition of al-Qaeda. It is quite possible that Ms Rice could have acknowledged publicly the bin Laden threat without actually grasping the full import of al-Qaeda.

Jonathan Raymond
Arlington, Massachusetts

In good faith

SIR – Thank you for mentioning the Palestinian Christians ("The season of the lambs", April 10th). This community, which regards itself as directly descended from the region's first Christians, now makes up only about 3% of the population in the occupied territories. There is genuine fear that the holiest sites of Christianity, including the Church of the Holy Sepulchre in Jerusalem and the Church of the Nativity in Bethlehem, will become mere museums.

Nesreen Souji
London

SIR – You refer to the Abrahamic roots of the three monotheistic faiths, and to the importance which they attach to a broken or penitent heart. In the Koran, Abraham asks for forgiveness on the day of resurrection "when wealth and sons avail not any man, save him who brings unto Allah a sound heart." The Arabic term for sound heart—*qalbun saleem*—also has clear overtones of purity and penitence.

Inayat Bunglawala
Muslim Council of Britain
London

SIR – Have you heard the one about the 77-year-old Muslim, the Jewish grandmother and myself, a Christian with Celtic leanings? We got together last year to think how we could help rural communities of all three faiths in the land we all consider holy. Since then we have planted over 10,000 olive trees in upper Galilee, enough to sustain 400 families. It is our way of acting in the spirit of "broken-heartedness" which you enjoin.

Eileen Fleming
Clermont, Florida

Demolition job

SIR – Britain should be praised, not castigated, for rejecting architectural monstrosities like those created by Zaha Hadid ("Zaha Hadidn't", March 27th). In recent years, the modern-architecture establishment has taken to aping modern art with its baleful assaults on beauty and humanism and its reliance on gimmickry. Moreover, these new architectural fads, like those of Ms Hadid and Frank Gehry, abandon the old reliable axiom that form should follow function in that they are unnecessarily expensive to build, do not make rational use of the space available and are inhospitable to human use. They can be great tourist attractions but only in the way freaks of nature used to pull in sideshow audiences. Would that British common sense prevailed in America, where people approve building these dreadful designs, probably out of a bourgeois fear of being thought philistine.

William Lloyd Stearman
North Bethesda, Maryland

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Israel and Palestine

Has something really changed?

Apr 22nd 2004 | CAIRO, JERUSALEM AND WASHINGTON, DC
From The Economist print edition

Getty Images

America's apparent tilt further towards Israel leaves the Palestinians with little room for manoeuvre. But they should grasp their chance in Gaza

Get article background

ARIEL SHARON, Israel's belligerent leader, is a happy man—for now. Despite initial cries of anguish from his most militant allies on Israel's hard right, his plan to withdraw unilaterally from the Gaza strip, the lesser (and grimmer) part of a future would-be-independent Palestinian state, seems to be winning the backing both of his own Likud party and of most Israelis. At a meeting with President George Bush last week in Washington, DC, he got just about everything he had hoped for, including the blunt endorsement of the annexation of chunks of territory in the West Bank (the main part of a hoped-for Palestine) that, by international law, do not belong to Israel.

Moreover, for the first time from the lips of an American president came a public dismissal of the notion that all Palestinian refugees, as part of a peace deal, have a right to return to their original homeland. It had always been highly unlikely that most of the refugees would be allowed back under any feasible Israeli-Palestinian deal; four years ago, President Bill Clinton acknowledged as much. But to have it so explicitly shoved into their faces, without much of a nod towards future negotiation, was a huge humiliation for the Arabs of Palestine and beyond.

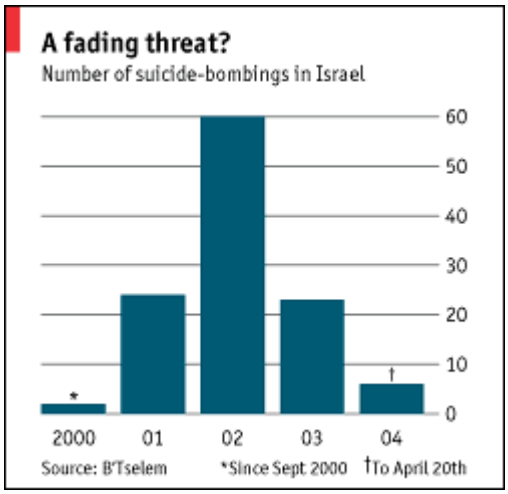
Just to rub home America's seeming acquiescence in Mr Sharon's roughest tactics, the Bush administration, alone in the world, refused—a few days after the Bush-Sharon meeting—to condemn the Israelis for assassinating Abdel Aziz Rantisi, the new leader of the Palestinians' Islamist terrorist movement, Hamas, a month after his predecessor, Sheikh Ahmed Yassin, had been killed in the same way. Is there nothing, ask irate Arabs and some Europeans, that America will do to rein in an Israeli government which, to most outsiders, seems bent on denying the Palestinians any hope of a viably independent state?

Mr Sharon still has a lot of arm-twisting to do back home if he is to win a solid majority of Likud's 200,000-odd members when they are asked, on May 2nd, to endorse the withdrawal plan. Four of the 13 Likud members of his coalition cabinet, and about one-third of Likud's 160 branch bosses, are still against. But the tide seems to be flowing Mr Sharon's way. Mr Bush's approval helped. This week the previously wavering foreign minister, Silvan Shalom, and the populist finance minister, Benyamin Netanyahu, came on board—provided, said the latter, that extra money is given to Jewish settlers on the West Bank.

The killing of Dr Rantisi may have been partly designed to reassure the doubters that Mr Sharon has not gone soft. Even the zealously pro-settler National Religious Party and the far-right National Union, the two most extreme bits of the ruling four-party coalition, which seemed almost certain, a few weeks ago, to storm out of the government, may be thinking of staying.

One reason is that, if they left, Mr Sharon would probably have to bring Shimon Peres and the Labour opposition into his team. Mr Peres would then start squeezing Mr Sharon to let the reviled Yasser Arafat, the Palestinians' long-ago elected president, back into the picture as a possible interlocutor. The far right may stay on to keep Mr Peres out and in the hope of stopping the virus of withdrawal spreading from Gaza to the West Bank. Yisrael Katz, the farm minister, who opposes the Gaza withdrawal, says that Mr Sharon is willy-nilly laying the groundwork for the removal of all Jewish settlements in the northern part of the West Bank too.

Supposing that Mr Sharon's Gaza plan goes ahead, his longer-term aims are harder to fathom. “Long-term interim agreements” have been a favourite ploy of his: that is, making tactical concessions to preserve a stalemate in the battle against Palestinian nationalism, in the hope that the Palestinians will eventually give up. On paper, Mr Sharon now accepts the idea of a two-state solution (itself a big *volte face* from the old Likud view that the Palestinians did not need a state, since “Jordan is Palestine”). But the sort of Palestinian state that might emerge, if the security barrier now being built follows a route that digs deep into Palestinian territory, would hardly be the viable entity that Mr Bush, let alone other involved outsiders, would accept as a bare minimum. Messrs Bush and Sharon did, however, accept that the fence may be temporary.



As for the killings of Hamas leaders or the Israeli government's stated intention to complete the security barrier (now about one-third built) within a year, Mr Sharon and his generals reckon that the military benefits are already plain. His head of military intelligence, Major-General Aharon Zeevi, says that Hamas has fallen into “shock and anarchy”. Other Israeli security analysts point to the sharp drop in the number of suicide-bombings (see chart) since the fence began to go up.

The future in Gaza

The real battle now is over the terms of Israel's withdrawal and its wider consequences. The Palestinian Authority (PA), set up after the Oslo peace accords a decade ago to give the Palestinians the basis of a fledgling government of their own in parts of the West Bank and Gaza, watched with rage and impotence as Messrs Bush and Sharon made their statements.

Few Palestinians seem to think that the assassination of Hamas leaders will weaken the movement, let alone smooth the path towards the emergence of new, moderate Palestinian leaders who will be able to run Gaza and be capable of returning to the negotiating table. A leading Palestinian opinion pollster, Khalil Shikaki, says that Mr Sharon's tactics have, on the contrary, already led to the “empowerment of Hamas, the fragmentation of Fatah [the main Palestinian nationalist movement, which is loyal to Mr Arafat], and the disintegration of the PA”. Hamas has the support of about one-third of Palestinians, has social networks in every walled enclave of the Palestinians' Israeli-occupied territories, and is thought to be gaining allies and sponsors throughout the region.

So for Palestinians the question is not whether a vacuum will be left at the head of Hamas, but who will fill it. Before they were killed, Sheikh Yassin and Dr Rantisi were negotiating with the PA for some kind of coalition to run Gaza, should the Israelis go. But they insisted that there could be no return to the days before the current *intifada* (uprising), which began in 2000, when the PA had the power and Hamas was a hounded opposition.

It is a measure of the PA's weakness and Hamas's strength that Mr Arafat agreed to such talks, authorising his formerly estranged security chief, Mohammed Dahlan, to negotiate the terms. The PA wants Hamas to hold fire in Gaza so as not to jeopardise Israel's withdrawal. Hamas wanted to test whether Mr Dahlan's good relations with European and American diplomats might enable him to persuade the Israelis to hold back militarily too. The killing of Dr Rantisi suggests they are loth, for the time being,

to do so.

The big decisions will now probably be taken by Hamas's leaders abroad. In the past, they have been harder-line than their colleagues inside Palestine, and have close ties to Syria and Iran, while liaising with the Lebanese guerrilla movement, Hizbullah. Its leading lights despise the PA. “What's the point of having a PA if it can't defend its people?” asked Khaled Mishal, Hamas's key man in Syria, last year. This week he called for “global war against America and Israel”, and for Arabs to rise against their “pathetic” regimes.

Exploiting the PA's collapse and Fatah's disarray, outside Arabs have already become more influential. Several West Bank cells of the al-Aqsa Martyrs Brigades, which have carried out suicide-bomb attacks in Israel but which once swore fealty to Fatah, have gone over to Hamas; others get cash and inspiration from Hizbullah.

Where would this leave Gaza, once Israel pulls out? Mr Shikaki urges Palestinian elections, to “enable Fatah and the PA to regain legitimacy through the creation of a new, trusted and accountable leadership”. A “young guard” of Fatah men might emerge, such as Marwan Barghouti, who came to the fore in the latest *intifada* and is now in prison. This new lot, however, would be just as fierce in resisting Mr Sharon's plans in the West Bank—and might also seek to accommodate Hamas.

The holding of Palestinian elections would require Israeli forces to withdraw not only from Gaza but also from the West Bank towns that the Israelis re-occupied two years ago. That, in present circumstances, is unlikely to happen. In any event, neither Mr Sharon nor Mr Bush wants a Palestinian vote that would reward Hamas and give a new lease of life to Mr Arafat's presidency, both of which, say pollsters, would almost certainly ensue.

Yet the worrying alternative might be the emergence of a new Palestinian movement with a stronger Islamist ideology and a wider regional reach. Last year Sheikh Yassin spoke of “an arc of resistance” stretching from Gaza to Baghdad. This month, a few days before he took up arms, the militant Iraqi Shia cleric, Muqtada al-Sadr, echoed him. “We are the striking arm of Hamas and Hizbullah in Iraq”, he said, “because the fate of Iraq and Palestine is the same.”

The view outside

What can be done by outsiders to bring Israelis and Palestinians (whoever represents them) back to the negotiating table? The first answer, as always, is not much. But the second is that it is still worth both Arabs and Europeans, among others, trying to badger the Palestinians into proving themselves to be necessary and worthy interlocutors, and to press the Israelis into accepting that a lasting peace can be sealed only if Palestinians have a truly viable state, as Mr Bush has urged.

After the Bush-Sharon meeting and the killing of Dr Rantisi, the Arabs' response in the region was predictable: anger in the streets, grim silence in the corridors of power. Condemnation is not enough, it must be matched with deeds, said the Arab League's head, Amr Moussa. But he did not say what deeds he had in mind, except to propose that Arab leaders, who were meant to gather for a summit in March in Tunis, would instead meet there at the end of May.

AP

Sore at finding themselves once again outmanoeuvred by Mr Sharon, there is little in the short run that Arab leaders can do to counter him. Countries still formally hostile to Israel, such as Syria and Lebanon, are military pygmies beside it. The governments of the Jewish state's other two Arab neighbours, Jordan and Egypt, are too closely bound to America to do much more than squirm and grimace at seeing Mr Bush endorse Israel's plans.

Jordan's King Abdullah showed his displeasure by abruptly cancelling a tête-à-tête scheduled this week with Mr Bush in Washington. He could hardly do otherwise. More than half of his 5m subjects are Palestinian refugees who have just heard Mr Bush confirm that they will never be able to return to their ancestral homeland. Jordan's king wished to avoid the kind of opprobrium that Arab commentators have heaped on

Gambler Sharon

Egypt's president, Hosni Mubarak, for being pictured in the cosy company of Mr Bush at his Texas ranch just days before Mr Sharon plucked a bigger prize from the White House. One Beirut editorialist sneered at Arabs “camped in the Washington waiting room”, while another suggested that leaders such as Mr Mubarak were complicit in Israel's killing of Palestinians.

America's Arab friends worry, above all, that Mr Sharon's plan just won't work. They fear it may instead seal the coffin of Mr Arafat's PA, boost Hamas's popularity, prolong Palestinian misery, and spread instability across the region, while not even bringing Israel's withdrawal from Gaza.

The Lebanese have another special concern. Almost the only thing that unites all their country's fractious sects is their adamant objection to the permanent settlement of some 250,000 Palestinian refugees who have lived there in squalor since 1948. Fictional as their hallowed “right of return” may have become, Mr Bush's abrogation of it highlights their plight.

The selfish neighbours

Balanced against such considerations, however, is self-interest. After so much costly unrest, Israel's neighbours crave a settlement of the Israel-Palestine conflict as much as its immediate victims. Last year, for example, the Middle East was the only region of the world to suffer a fall in the inflow of private capital—by some 45%.

If the cost of addressing such problems is to “sell out” the Palestinians, some of the region's leaders may be quietly willing to pay it. They would justify themselves by pointing to the failure of the Palestinians' own leadership. Egypt, for example, has tried for months to coax the various Palestinian factions to agree to some kind of power-sharing formula. “Of course Sharon is a butcher and a thug, but it is the Palestinians themselves who have allowed him to bypass them,” says a gloomy Egyptian analyst. But no Arab leaders are keen, publicly at any rate, to promote an alternative leader to Mr Arafat, even though he has long exasperated most of them.

Most Arabs accept that this American administration, in any event until after the presidential election in November, is bound to ignore their protests against Mr Bush's endorsement of Mr Sharon's plan for Gaza. The alternative, John Kerry, has endorsed it too. The angrier among them, especially the Palestinians themselves, cast a longing eye at Iraq, where they hope that America will receive a bloody nose, which in turn, they hope, will give renewed vigour to the *intifada* and weaken America's resolve to impose its own solutions in the Middle East.

After the United States, the European Union has been the most active player in the “quartet” of powers (the others being the UN and Russia) trying to promote a “road map” towards peace in Israel-Palestine. The EU now hopes that Israel's withdrawal from Gaza will be both rapid and orderly—and allow it to engage in the sort of institution-building and economic resuscitation that might make Gaza a model for other parts of the Palestinians' now-occupied territories.

That would almost certainly mean helping the various Palestinian factions—in essence, Hamas and Fatah—to co-operate. That can be done only with Israeli approval. If Israel continues to hammer Hamas, or encourages other Palestinians to do so, more turmoil in Gaza could ensue. But if Palestinians in the strip let the withdrawal happen peacefully, there is a chance it could lead to better things, and even, eventually, bring Palestinians back to the negotiating table.

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Israel's nukes

Vanunu's story

Apr 22nd 2004
From The Economist print edition

Nobody emerges well from the sorry tale of Israel's nuclear whistleblower

ON APRIL 21st, Mordechai Vanunu walked out of a prison in Ashkelon, in southern Israel, after 17½ years, two-thirds of them spent in solitary confinement. He flashed victory signs at the cheering foreign fans who lionise him as a martyr to the cause of disarmament—ignoring the jeers of the protesters who, like most Israelis, revile him as a traitor.

Until 1985, Mr Vanunu worked as a technician at Israel's secret nuclear reactor at Dimona, in the Negev. In 1986, after drifting around the world and converting to Christianity—a defection that, he alleges, explains the severity of his treatment—Mr Vanunu leaked details and photographs of Dimona to Britain's *Sunday Times*. But before his revelations were published, he was honey-trapped in London, lured to Rome and smuggled back to Israel by yacht. Before he was convicted of treason and espionage, Mr Vanunu scrawled an account of his kidnapping on his palm and pressed it to the window of a van. He now claims that the bait for the trap was an American agent, rather than one from Mossad.

Though he says he has no secrets left to spill, Mr Vanunu's contacts with foreigners and the media will still be restricted. He is banned from leaving Israel, and his movements within it will be circumscribed. Some of these strictures may be overturned in the courts.

But the fact that Mr Vanunu is still being persecuted doesn't make him a saint, or the programme he exposed illegitimate. He and others question why Israel should be treated differently from other countries suspected of pursuing a bomb (and he called this week for Dimona to be opened up to weapons inspectors). One answer is that Israel is not a signatory to the Nuclear Non-Proliferation Treaty. And given the tumult of its short history, it has an unusually clear and powerful need for a trump-all deterrent. Its current conventional military superiority over its neighbours, and the acceptance by some of them of its existence, makes that case weaker than it used to be, and strengthens the case for a Middle East entirely free of weapons of mass destruction. But Israel still has reasons to feel endangered.

Still, as the eponymous character in “Dr Strangelove” observes, isn't “the whole point of a Doomsday Machine ...lost if you keep it a secret”? In fact, even before Mr Vanunu sold his story, Israel's nukes were only half a secret. Under a policy of “nuclear ambiguity”, Israeli officials refused to discuss them, and still do. The policy has until now proved successful and resilient: it is less inflammatory than declaring the programme openly, and it avoids embarrassing or alienating America. Quite aside from the question of Mr Vanunu's rights, by cack-handedly helping him to attract the world's attention—rather than letting him drift into exile—Israel may now inadvertently be undermining the policy Mr Vanunu wanted to change.

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The economy

And for my next trick

Apr 22nd 2004 | WASHINGTON, DC
From The Economist print edition

Can Alan Greenspan move the American economy smoothly towards higher interest rates?

Get article background

THE chairman of the Federal Reserve may no longer have the aura of infallibility that he enjoyed in the go-go years of the 1990s, but he is still credited by many with a magic touch when it comes to monetary policy. Alan Greenspan's most recent wizardry—a willingness to slash short-term interest rates to 1% and keep them there—helped America stave off a sharp recession and bolstered a long shaky recovery. Soon he must pull off another, possibly tougher, trick: raising interest rates back to more normal levels without either undercutting the recovery (by moving too soon or fast) or letting inflation or asset bubbles get out of hand (by waiting too long).

Listen to Wall Street, and Gandalf is about to swing into action. Over the past couple of weeks a slew of strong economic statistics (especially the creation of 308,000 new jobs in March) followed by news that inflation jumped unexpectedly, has sent financial markets into a frenzy of speculation that the central bank will tighten soon—and aggressively.

Only weeks ago, it was conventional wisdom that the Federal Reserve would keep short-term interest rates unchanged until next year. After the inflation and jobs numbers were published, futures markets began to price in the near certainty of a rate hike in August. Some economists even expect the Fed to move in June, with more raises possible before Americans go the polls in November. By the end of next year many in the markets expect short-term rates to be at 3.5%.

This week the magician himself spoke, in two testimonies to Congress. Not surprisingly, his message was both more balanced and nuanced than the thunder from Wall Street. Mr Greenspan was clearly preparing the ground for tighter policy but without suggesting that a move was imminent. He noted—as he has done before—that interest rates “must rise at some point” to prevent inflation from taking off, but suggested that “as yet” the long period of low rates had not “fostered an environment in which broad-based inflation pressures appear to be building”.

Nonetheless, compared to the Fed's last official statement on interest rates in March, Mr Greenspan was noticeably more upbeat. In March, the central bank still saw the risks of lower inflation as slightly higher

than those of inflation. This week, Mr Greenspan suggested that the disinflation trend had “come to an end” and that the threats of deflation were “no longer an issue”. He described the outlook for America's economy as “good”. Significantly, he did not use the word “patient” when discussing how long the central bank could keep rates low. Though much of the testimony dwelt on why there was scant risk of inflation getting out of control, Mr Greenspan was clear that the Fed would “act, as necessary” to maintain price stability.

While Wall Street is fretting about out-of-control inflation, Mr Greenspan and his colleagues in Washington, DC, are relieved that inflation has stopped falling. Despite its recent acceleration, America's inflation rate is extremely low. Excluding the volatile categories of food and energy, the consumer-price index rose 1.6% over the past year. Other measures preferred by the Fed are hardly thrusting skywards. Given the worries about deflation, many central bankers see a small acceleration in consumer prices as a sign of success.

One question looms: is the inflation uptick due largely to one-off factors, such as higher commodity prices, or is it the beginning of a pernicious wage-price spiral? Many Fed governors play down the risk of the latter, pointing out that the labour market is still relatively slack. Despite the March employment figures, the current recovery looks anaemic in terms of job creation; until that changes, they argue, there is scant risk of price pressure being translated into higher wages.

But the central bankers' view of the job market seems to be changing—at least a little. A few weeks ago, when the March jobs figures came out, Roger Ferguson, the Fed's vice-chairman, played down their significance: it would, he said, take “some time” to see whether the improvement in the labour market was “fundamental and durable”. By contrast, Mr Greenspan's tone this week was much more upbeat. He expects the pace of hiring to stay strong.

Yet even with faster job growth, Mr Greenspan seems sanguine about inflationary pressure. There is still, he points out, a “sizeable margin” of slack in the economy; productivity growth remains strong. Fat profits also give firms room to absorb higher wages without raising prices. All those factors allow the central bank wiggle-room before rates must rise.

This analysis is not shared by all of Mr Greenspan's colleagues on the Fed's interest-rate-setting committee. The presidents of district central banks, in particular, tend to be more hawkish about inflation. For instance, Bill Poole, president of the St Louis Fed, is concerned about falling behind the inflation curve. He reckons that the Fed must act “aggressively” when inflation risks change. Bob McTeer, president of the Dallas Fed, said this week that the March rise in consumer prices was “disturbing”.

In practice, however, it is Mr Greenspan's views that count most—and his goals seem to be to prepare the markets for higher rates, but not necessarily to rush to action. The reason is partly tactical: if you spend enough time preparing Wall Street for higher rates, the eventual move may not roil the highly leveraged markets (see article).

America's rock-bottom interest rates have not just supported spending; they have also coaxed investors into gambling on borrowed money. Raise rates unexpectedly, or too quickly, and the unwinding of these investment bets could cause chaos in financial markets. Given consumers' dependence on housing wealth, a meltdown in the mortgage market alone could be enough to snuff out the recovery. Memories of 1994, when the Fed began a sharp tightening cycle, are still fresh. Then bond markets collapsed as investors appeared surprised by the central bank's moves. It is an experience Mr Greenspan will not want to repeat.

In all likelihood, the Fed will send a bevy of signals before it actually raises rates. This week's testimony is best seen as the opening salvo. But signalling is not a simple business. In June 2003, Mr Greenspan's efforts to convey his concern about deflation backfired when the central bank failed to cut interest rates by as much as the market expected. And investors can often refuse to take the hint. Fed officials reckon that they sent clear signals about tighter policy in 1993: Wall Street ignored them.

Judging by Wall Street's jitters, that looks unlikely to happen this time around. After Mr Greenspan's comments this week, no one can be surprised if rates rise later this year. But there are still enormous uncertainties about how to get from today's rock-bottom interest rates to more neutral levels. It is not just a question of when the central bank starts to raise rates, but how far they are raised and how fast. If he is to pull off his monetary magic once again, Mr Greenspan will have to become clearer on both counts.

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New York cabs

Taken for a ride?

Apr 22nd 2004 | NEW YORK
From The Economist print edition

Higher fares for an unfair racket

IF A city goes to the bother of regulating its taxi industry, it should presumably have the interest of residents at heart. How then, to explain the system in New York? It benefits neither passengers nor drivers. Instead, most of the proceeds flow to a third group of “medallion-holders”—the people who own the aluminium badges that give a taxi the right to pick up passengers on the street. The going rate for a medallion is now about $300,000, so they are usually owned by investment companies, investors or partnerships rather than the driver.

These monopoly franchise rights were granted back in the Depression, when the notion of using rationing to fight deflation seemed like a good idea. In 1937, 11,787 cab licences were handed out at $10 each. Remarkably, no more medallions were handed out until 1996 when the city, desperate for money (again), sold off another 400. Since then, flogging off new medallions has become a nice little earner; over the past two weeks, the city has been auctioning off 300 of the things—and 600 more will be sold over the next two years.

The city has budgeted $65m in revenues annually from these auctions, but the true figure may be closer to $100m. The value of the medallions has risen thanks to the city's helpful decision to raise fares by 27% just before the auction. Since most of the costs in the cab trade are fixed, most of the extra money will go straight to the medallion-holders' pockets.

The auction is arguably just a consumption tax—and an inefficient one at that, because the city splits the bulk of the proceeds with the medallion-holders. Meanwhile, the city's preoccupation with boosting medallion prices helps to explain a lot of things: why New York has relatively few cabs; why they are getting ever costlier; why only poor immigrants are prepared to be drivers; and why no one looks after the cabs.

To be fair, the new fare structure is supposed to help fix some of the worst problems, notably the absence of cabs during the early evening rush hour. Typically, just as demand begins to pick up, the streets are gridlocked with off-duty cabs driven by a day-driver rushing to hand over the car to a night-driver by 5pm (the idea being that each driver should have one busy period during his shift). The fare structure has now been fiddled with to bring the handover closer to 4pm. If the fare could now be weighted less towards the pick-up point, and was higher per mile, drivers might be less inclined to fake engine trouble to avoid leaving central Manhattan.

The city says the drivers earn $13 an hour. Drivers put the figure at half that level, and add that they have to pay their lease fees to medallion-owners upfront. Evidence of the unattractiveness of the job can be found outside any cab garage, where numerous taxis are available for lease with no takers.

The city hopes that the drivers' income will rise to $20 an hour under the new fare structure. The chances are that most of this will be eaten up by higher lease prices. Most drivers have little bargaining power; having no credit histories, they cannot buy medallions themselves. Meanwhile, the share price of Medallion Financial, the biggest company in the industry, has doubled in the past year.

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Arnold Schwarzenegger

Easy stuff, government

Apr 22nd 2004 | LOS ANGELES
From The Economist print edition

Another useful victory for the gubernator. Next stop: the budget

Get article background

PERHAPS Arnold Schwarzenegger's next trick will be to walk on water. In the past six months he has exchanged a fading movie career for the governorship of California; persuaded a reluctant electorate to borrow $15 billion to keep the state solvent; and even, while on an Easter break in Hawaii, helped save a man from drowning. The latest feat, signed into law on April 19th, is to strong-arm the Democrat-dominated legislature into reforming the workers' compensation system. “We are making our state once again a powerful, job-creating machine,” says the perpetually beaming governor.

That may, of course, turn out to be wildly optimistic. After all, this is the fifth reform of “workers' comp”—a no-fault system of insurance payments for workplace injuries—since 1982, and the fourth reform was less than a year ago. In litigious California, the awards have soared, helping to drive 25 insurers out of business in the past decade. Those who remain in the market (including the state's own insurer of last resort) have raised their premiums, leaving employers with the most expensive system in the country. Spending on workers' comp rose from $2.68 per $100 of payroll in 2000 to $6.30 last year (which compared with a national average of $2.46). For some construction companies, premiums rose to a staggering $50 per $100 of payroll.

The governor hopes that these costs will now fall by up to 30%, thanks to tighter controls on a worker's choice of doctor and stricter limits on pay-outs. He may be right, but there is no guarantee that the savings will actually be passed by the insurers to the employer: in order to win Republican backing, the new reform leaves rates unregulated. That could be a mistake: when rates were deregulated in 1993, the perverse result—after an initial burst of rate-lowering competition—was higher premiums to pay for increased benefits.

Still, allow the former Terminator to bask in his victory. He has again proved that his personal popularity with the electorate can trump the partisan posturing in Sacramento. In March he persuaded voters to approve Proposition 57, allowing him to issue a $15 billion bond to tidy up the state's historic budget liabilities. This time, he threatened to back a radical workers' comp initiative in November if the politicians did not agree on a compromise by April 16th (the deadline for a ballot proposal). With the governor having collected nearly 1m signatures, roughly twice the number necessary, the Democrats (who get a lot of money from lawyers) gave way.

The next test of this centrist populism will be the budget negotiations for the 2004-05 financial year beginning in July. In seeking to close a potential deficit of about $16 billion, the governor is proposing spending cuts of $7.3 billion, much of it from popular education programmes. In addition, Mr Schwarzenegger is making some heroic assumptions of increased revenue: $500m, for example, from Indian tribes that run casinos. Even then, according to the state's non-partisan Legislative Analyst's Office, a “structural” deficit of some $6 billion will still remain at the start of the 2005-06 year.

Does that mean that Governor Arnold will have to raise taxes? Many in Sacramento, including Steve Westly, the state's financial controller, believe he has no choice. Ronald Reagan, another movie-star turned governor, raised taxes; so did the last Republican governor, Pete Wilson, in the early 1990s, though he then faced relentless harrying from his own party.

Mr Schwarzenegger did a little kite-flying in March, when he mused in a rare interview that perhaps his anti-tax stance was “wishful thinking”. One option might be to use Proposition 58, which was packaged alongside Proposition 57, as a tough new pledge to match spending to revenue. One little-publicised

provision gives the governor the right to suspend its strictures if a “fiscal emergency” arises. That might allow some book-fiddling.

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The electoral week

On the trail

Apr 22nd 2004
From The Economist print edition

Peace, man

“We're calling him 'Psychedelic Bush.'”

A White House insider on the president's bouffant hair and bright tie at his press conference last week, US News and World Report*, April 26th*

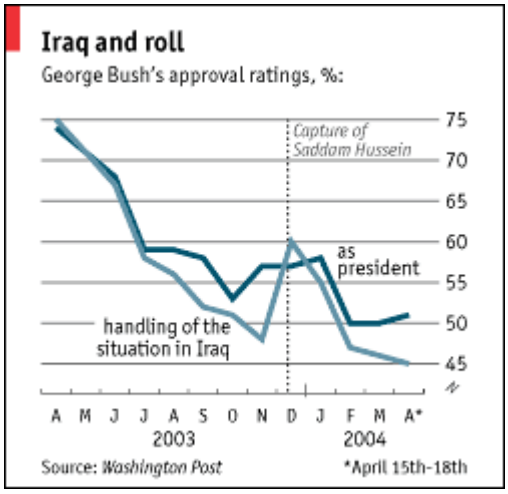
Damn annoying, really

“I have met him. And it's my job to work with the president of the United States...the person that is the president of the United States is for the American people to choose, not me.”

Tony Blair on John Kerry and his own lack of clout, This Week, ABC, April 18th

Cookie power

MoveOn.org, an anti-Bush organisation, supervised “Bake Back the White House”: some 500,000 volunteers, including “celebrities” such as Moby, Al Franken and Janeane Garofalo, raised $750,000 for the cause by selling cookies, pies and brownies.



Casualties of war

Six swing states—Iowa, Wisconsin, Arizona, Pennsylvania, New Hampshire and Tennessee—have suffered higher than average war deaths. The average is 2.38 deaths per million residents.

Chicago Tribune*, April 18th*

Shaken, not stirred

“I'm not voting for [Mr] Bush. But I'd rather eat dirt than vote for John Kerry.”

Kenneth Sanchez of the Log Cabin Republicans, a gay group opposed to Mr Bush's support of a constitutional marriage amendment, Los AngelesTimes*, April 18th*

Sex, hunting and rock-n-roll

“Jerry [Garcia] got high and Jerry's dead. I went hunting and I'm still Ted.”

Ted Nugent takes members of the National Rifle Association through the lifestyle choices of a rock-star. He also came out against John Kerry, Pittsburgh Post-Gazette*, April 19th*

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Sierra Club elections

Rock the vote

Apr 22nd 2004
From The Economist print edition

Environmentalists are divided about whether to restrict immigration

Get article background

JOHN MUIR, the great champion of America's western wilderness, found “no repose like that of the deep green woods.” Were Muir alive today, he might be taking cover there. The Sierra Club, the environmental-advocacy group he helped to found in 1892, has been shaken by a row over who should sit on the board of America's most powerful green organisation.

Five of the 15 slots were open this year, but this was not an election like any other. Alongside the usual run of candidates was a trio of dissenters, on the ballot because they had collected enough signatures, who were understood to favour clamping down on immigration to America. Most prominent among these was Dick Lamm, a former governor of Colorado. Mr Lamm wants the club to revive its pre-1996 position of stabilising population growth at home. Another candidate joined the ballot just to urge members to vote against Lamm and his allies, and the “greening of hate”.

When the issue of immigration last raised its head, in 1998, Sierrans, a fairly leftish lot, chose to take no stand on it one way or the other, but to focus instead on controlling global population growth through means such as family planning. (They also campaign for “fair trade” to raise labour and environmental standards in poor countries, which, on their theory, could make the poor less eager to emigrate to America anyway.) Charles Wilkinson, a professor at the University of Colorado's law school in Boulder (who is not part of the Sierra debate), says that environmentalists should recognise global population growth, whether by immigration or otherwise, as “the ultimate issue”. But most of them are afraid to touch it.

The immigration row also shows up holes in the Sierra Club's structure. The club prides itself on its grassroots credentials: local chapters have a good deal of authority, and it is one of few environmental groups that allows members to elect the board. But club officials worry that non-environmental groups could influence elections by backing petition candidates.

In an extraordinary note accompanying this year's ballot, Larry Fahn, the president, gave warning that groups ranging from the National Alliance (white separatists) to AZHemp.org (pro-legalised marijuana) could be trying to meddle, and urged members to cast votes “as a means of demonstrating to outside groups that they cannot influence our organisation.” Some of the petitioners, including Mr Lamm (a club member in the 1950s and 1960s) joined in 2003, shortly before being put on the ballot. Mr Fahn says the club is now considering requiring board candidates to be members for at least five years, or to have a title within the organisation.

On April 21st, to the relief of most of the rank and file, the insurgents were crushed. But the board's wounds will linger. Mr Fahn says there is already a “serious rift” over immigration: a handful of existing board members favour restricting it, while the rest take a more liberal view. Still, the club may yet be able to unite as the presidential elections draw near. Nearly all the candidates, regardless of their views on immigration, insisted that ousting George Bush should be the top priority this year. The activists can now devote themselves to that struggle.

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Guantánamo Bay and the Supreme Court

A lawless enclave?

Apr 22nd 2004
From The Economist print edition

Amid much noise and fury from abroad, American justice inspects itself

IN A case that pits the powers of a wartime president against the federal courts, the Supreme Court struggled this week to decide whether the 595 foreigners being held at an American naval base in Guantánamo Bay, Cuba, should have the right of access to American courts. Most have been held for more than two years without charge and without access to lawyers, family or consular officials. It is the biggest test so far for the Bush administration's aggressive legal strategy.

Arguing on behalf of 14 detainees from Kuwait and Australia (the two British detainees originally involved in the case were released in February), John Gibbons, a retired federal appellate judge, accused the American authorities of creating a “lawless enclave” at Guantánamo. “What is at stake is the authority of the federal courts to uphold the rule of law,” he said, arguing that people in federal detention have had the right to petition the American courts for *habeas corpus* for 215 years.

Theodore Olson, the solicitor-general, replied that allowing judicial review of the detainees' rights “would place the federal courts in the unprecedented position of micro-managing the executive's handling of captured enemy combatants from a distant combat zone” and of “super-intending the executive's conduct of an armed conflict.” This, he said, would raise “grave constitutional concerns” regarding the separation of powers.

The Bush administration asserts the right to hold and interrogate the detainees for as long as it likes—indefinitely, if necessary—without formal charges or trial, though it is planning to bring some before military commissions. It claims that the men, mostly picked up in Afghanistan, are neither prisoners of war nor “protected persons” under the terms of the Geneva Conventions, and that they therefore have no legal protections at all.

Despite the howls of fury from around the globe about the detainees' plight, the current case does not concern their innocence or guilt, but simply whether American courts have jurisdiction. The key is the status of the Guantánamo base, leased in perpetuity to the United States by Cuba in 1903. Under the terms of that agreement, the United States has “complete jurisdiction and control” over the base, while Cuba retains “ultimate sovereignty”.

Mr Gibbons pointed out that Cuban law had never had any application inside the base. “A stamp with Fidel Castro's picture on it wouldn't get a letter off the base,” he noted. But the government argued that “sovereignty, not mere control, is the touchstone”, and so it was beyond the remit of American courts.

“Friend of court” briefs have been filed on behalf of the detainees by, among others, former American prisoners of war and 175 members of the British Parliament. Arrayed on the other side are various former attorneys-general, other retired soldiers and numerous conservative jurists, including Robert Bork. “If the court, for the first time in history, interposes the federal judiciary between our armed forces and enemy belligerents held abroad,” he warns in his brief, “the court will effect a dangerous and unprecedented revolution in the separation of powers and undermine the ability of the US military to protect our citizens from attack.”

There is the usual desperate searching for clues as to the nine supreme justices' inclinations. One supposed hope for the detainees: to some ears, most justices sounded sceptical about the administration's claim that the president alone had control over the fate of the detainees. On the other hand, the court has been reluctant to challenge executive decisions in time of war. As expected, conservatives (such as Chief Justice William Rehnquist and Antonin Scalia) seemed more sympathetic with the government; liberals (Ruth Ginsburg and Stephen Breyer) appeared to lean towards the

prisoners.

Next week, the court is due to hear arguments concerning the rights of two American “enemy combatants” being held on naval brigs off the mainland, who have also been denied access to the courts. The Supreme Court's ruling in both cases is not expected until the end of June.

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Mid-western casinos

Taking chances

Apr 22nd 2004 | CHICAGO, ILLINOIS, AND FRENCH LICK, INDIANA
From The Economist print edition

Why gambling is an awkward business for politicians

IN THESE cash-strapped times, very few things cheer up state politicians as much as talk of a new casino. What better way to generate a little new revenue, not to mention create a bundle of jobs, than allowing some good clean fun at the tables?

AP

Good clean fun in French Lick

Alas, casinos remain a business where fun tends to come with muddy politics. Take Illinois, for instance. The governor, Rod Blagojevich, and his supposed Democratic allies in the legislature are certainly on the lookout for more money. The state's outstanding debt has now reached $52 billion, and the governor wants to increase borrowing still further. So a little money from gambling taxes would be useful.

But the state's latest attempt to build a casino—its tenth—has run into trouble. Last month the state's Democratic attorney-general, Lisa Madigan, caused a ruckus when she claimed there was “organised crime influence” in Rosemont, a Chicago suburb that had just been chosen by the Illinois Gaming Board as a site for the joint. As part of the decision, the board awarded a licence to Isle of Capri Casinos of Mississippi (the previous holder, Emerald Casino, having gone out of business).

In 2001, a joint casino bid by Rosemont and Emerald was denied because of concerns about suitability. This time round, the gaming board's own staff had suggested another town, and one of the board's five members had worried about alleged Mafia ties. Ms Madigan has particular problems with Rosemont's mayor, Donald Stephens, who had a past business connection with the family of the late Chicago mob boss William “Willie Potatoes” Daddano, as well as Nick Boscarino, who was convicted in February of a scheme to defraud the town. Despite all this, the gaming board's chairman insists that a Rosemont casino would not be “mobbed up”. Besides, it is close to Chicago's main airport, and would thus generate more revenue for the state than other sites.

Now Mr Blagojevich has intervened himself, calling for an independent review of the gaming board's decision. The young Democratic governor seems increasingly at political odds with Ms Madigan and her father, who is the powerful Democratic speaker of the state House. But both he and Ms Madigan are also running into opposition from the gaming board, which is resisting all attempts to interfere in its affairs.

In next-door Indiana, politicians are rather hoping that they have settled a rumpus about their state's eleventh casino. The site, near French Lick in Orange County, seems ideal from a historical perspective. A century ago, Hollywood stars, Washington politicians and Chicago gangsters used to descend on the southern hill country to stay at grand hotels, soak in natural mineral springs and gamble the night away

at a slew of casinos. But the area's last casino closed in 1949. Today the remote valley has one of the highest jobless rates in Indiana—and is perhaps best known as the home of Larry Bird, a basketball superstar (“the hick from French Lick”), and for its small Amish community.

Getting gambling back to French Lick has involved more than a decade's-worth of wrangling. Last year, the state legislature granted its approval; then a local referendum passed comfortably. This week proposals are due from at least three aspiring casino operators. One of the groups includes Donald Trump; the second includes Mr Bird; and the third has a French partner. A winner will be named this summer.

The casino operator will have to work hard to boost the area, including filling rooms in the still-shuttered West Baden Springs Hotel (once billed as the “Eighth Wonder of the World”). But the locals are still less than unanimous in their support. It is hard to imagine the Amish and Mr Trump having much in common.

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Lexington

The warrior president

Apr 22nd 2004
From The Economist print edition

Militarism is still George Bush's best card

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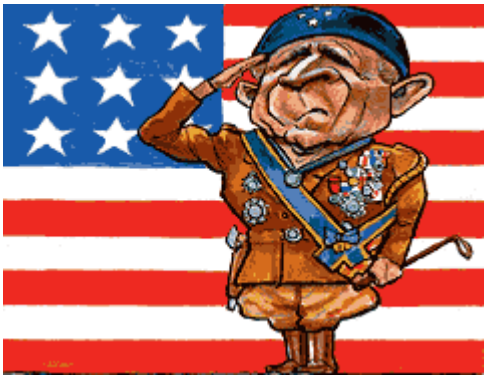

GEORGE BUSH may not have been the most diligent student at Harvard Business School; but the one class that he certainly seems to have absorbed was brand-management. In 2000 he branded himself as a “compassionate conservative”—and stuck to that message remorselessly. This year he is equally relentlessly branding himself as a “war president”.

Mr Bush is forever giving speeches surrounded by troops, and forever emphasising the importance of courage and commitment. The Republican convention in New York this September is intended to drive one point home: that ever since September 11th 2001, a warrior president has been engaged in an all-out war on Islamofascism.

Two years ago this re-election strategy looked like a “slam dunk” (to borrow George Tenet's unfortunate phrase about weapons of mass destruction). Even a year ago it looked hard to resist. Now the context has changed dramatically. To understand how dramatically, consider who is more likely to use footage of Mr Bush's “mission accomplished” landing on the *USS Abraham Lincoln* last year—the Democrats or the Republicans?

The first blow to Mr Bush's warrior strategy was the Democrats' decision to nominate a Vietnam war hero rather than an anti-war blowhard. John Kerry's campaign has hardly got off to a rip-roaring start. But he is nevertheless well-placed to undermine Mr Bush's core message by branding himself as “the real thing” when it comes to war leadership: a man who fought in Vietnam rather than skulked in the National Guard. Mr Kerry's war record—brave in the field, sceptical afterwards—could well become an appreciating asset as more people become convinced that Iraq is another Vietnam.

Mr Bush's warrior strategy has suffered two further blows since the Democratic primaries. The first is the September 11th commission. It is no wonder that the White House fought tooth and nail against the establishment of this commission. It has shone a bright spotlight just where the administration did not want it, on its “failure” to prevent September 11th. It is now clear that the administration had plenty of warnings that al-Qaeda was planning an earth-shattering attack on American soil, and that both the FBI and the CIA failed to act on specific leads. Far from being a warrior president, Mr Bush risks being thought of as asleep on his watch, holidaying in Crawford rather than bullying his cabinet to focus on the mounting terrorist threat.

The commission would never have materialised without the lobbying of a group of September 11th widows—particularly a quartet known as the Jersey Girls. These widows are likely to remain a thorn in the warrior president's side for the rest of the political season. They have already made a fuss about the Republicans' decision to use pictures of the flag-draped remains of victims of September 11th in an election ad, and may cause an even bigger fuss if Mr Bush's people try to exploit Ground Zero during their convention. Indeed, Republicans are already worrying that Karl Rove's “masterstroke” of holding the Republican convention in New York may yet be remembered as a crass attempt to exploit a national tragedy for partisan gain.

But the biggest problem for Mr Bush's warrior strategy is the deteriorating situation in Iraq. Michael O'Hanlon, a hawkish Democrat at the Brookings Institution, puts it nicely. If you want to play the part of

John Wayne, it is not enough just to walk with a swagger; you need to make sure that your gun is loaded and that you have sized up your opponent correctly. Mr O'Hanlon points out that America's warrior president is currently suffering one of the biggest indignities imaginable—being out-thought by a bunch of “Baathist dead-enders”.

So has Mr Bush made a fatal error in deciding to brand himself as a warrior president? Not really. First, consider the alternatives. Mr Bush's poll numbers for “compassion” are surprisingly robust for a Republican. But when it comes to actual policies, compassionate conservatism has produced little more than warm wind. Yes, the economy is beginning to roar back, but by some counts 80% of the jobs created are part-time ones that usually come without health care and other benefits. And Americans are obsessed with the spiralling price of petrol.

Those buoyant polls

Second, look at how well Mr Bush's image as a warrior president has withstood the extraordinary battering of the past few weeks. The credibility of the September 11th commission is collapsing like a poorly cooked soufflé in a mess of partisan finger-pointing and publicity-chasing. While Americans may have adjusted their view of the warrior president, they draw the line at blaming him for September 11th (and will probably punish any Democrats who dare suggest it). Even the Jersey Girls are in danger of overplaying their hand by often appearing to blame the Bush administration more than the hijackers. As for Mr Kerry, the Democratic senator still sounds hopelessly confused about Iraq, thanks partly to his own convoluted voting record on the war and partly to the deep divisions within his own party between the anti-war left and the moderate middle.

Even the mess in Iraq is not producing the sort of backlash against the warrior president that you might expect. The latest opinion polls, taken after several terrible weeks in Iraq, show Mr Bush increasing his lead over his rival, as attention focuses on security. Mr Bush still leads Mr Kerry by about 20 points when pollsters ask Americans about issues like “protecting the country” and “fighting terrorism”. For the time being at least, anything that shifts the focus to terrorism benefits Mr Bush.

Running as a warrior president is certainly no slam dunk. But it is the best card the president has; and, on the current evidence, it has a slightly-better-than-even chance of success of trumping anything Mr Kerry puts on the table.

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Argentina's energy shortage

The laws of economics bite back

Apr 22nd 2004 | BUENOS AIRES
From The Economist print edition

Government bungling over privatised energy companies has cast a shadow over Argentina's robust economic recovery

Get article background

“THERE is crisis. What there isn't is emergency.” With those carefully chosen—if hardly reassuring—words, Daniel Cameron, Argentina's energy secretary, finally admitted last week what many economists and some public officials have been saying for many months: that energy shortages pose a serious threat to Argentina's vigorous recovery from its debt default and a chaotic devaluation in 2001-2.

The signs of trouble began to appear last month. Some factories suffered power cuts. The voltage supplied to homes across the country dipped slightly. And without warning, the government decreed a 15% cut in exports of natural gas to Chile, and halted sales of electricity to Uruguay. But the worst is yet to come: during the southern-hemisphere winter, from June to August, electricity use traditionally rises. With the economy growing at around 10% a year, and demand for energy rising at a similar rate, Argentina faces the prospect of two or three years of power shortages.

The energy bottleneck could curtail the economy's growth by anything between two and five percentage points over the next two years, according to estimates by independent economists. It has placed Argentina's relations with its neighbours under strain. It also represents a political failure for which Argentines may come to hold Néstor Kirchner, their president since last May, personally responsible.

The vigour of the economic recovery and the weather are two of the factors behind the crisis. Two-fifths of Argentina's electricity supply comes from hydro-electric plants, which have been hit by a drought; most of the rest comes from gas. But the main causes lie elsewhere: in an ideological battle, and in the legacy of the traumatic devaluation of January 2002, which ended a decade in which the peso was pegged at par to the dollar.

Reap what you sow

Utility tariffs had been fixed in dollars. The government of Eduardo Duhalde, Mr Kirchner's predecessor, converted them to pesos at par and froze them. At the time, it said it planned to renegotiate the contracts of the utilities. But what was initially an emergency measure—taken out of fear of the social impact of tariff rises on a newly impoverished country—has congealed into a political statement.

Mr Kirchner is a critic of the way in which Argentina's public services were privatised by Carlos Menem in the 1990s. His supporters argue that the privatised companies, most of which are foreign-owned, made exorbitant profits while failing to invest sufficiently in their industries, preferring to engage in financial speculation. This combative stance—like Mr Kirchner's lambasting of private creditors and other bogeymen—has contributed to his extraordinary popularity.

The president's closest allies, led by Julio de Vido, the minister of production and Mr Cameron's boss, now argue that if energy is in short supply, it is because the companies have not invested properly since the mid-1990s. They have been insisting that tariffs should not be increased until investment restarts.

Such charges are true of some privatised businesses, but not of the energy firms. By common consent, electricity was the most successful of Mr Menem's privatisations. By 2001, Argentina had become “the most efficient energy producer in Latin America”, having moved from being an importer in the 1980s to exporting oil, gas and electricity, points out Fernando Ponasso, the president of the association of electricity distributors. And though some companies may have fiddled their accounts in order to ship extra money abroad before the devaluation (they deny it), a new power station came on stream as late as 2002. Thanks to big investments in modern gas-fired stations, the wholesale price of electricity fell from $50 per megawatt-hour in 1992 to $22 in 2001.

The results of the tariff freeze have been predictable. Though it may be a surprise to Mr de Vido, the law of supply and demand applies in Argentina too. Most Argentines now pay only a third as much as their neighbours for gas and electricity. So demand has soared. Each month, some 30,000 of them have been converting their cars to run on compressed natural gas, which costs 40 centavos ($0.14) a litre, compared with 2 pesos ($0.71) for petrol. Meanwhile, since prices are at around one-third of the level required for a reasonable return on investment—and many of the electricity companies are in default on their dollar debts—supply has stagnated.

The government has cast around for quick fixes. It has arranged to import electricity and diesel from Brazil, and this week signed a deal to buy gas from Bolivia. Carlos Mesa, Bolivia's president, has felt impelled by his demagogic nationalist critics to insist that “not a molecule” should be re-exported to Chile, with which Bolivia has a century-old territorial spat.

Mr Kirchner has also quietly moved to increase some tariffs, by 35% or so for industrial users of electricity and gas (though the gas rise will not take effect until after a public hearing next month). The government has promised gas producers that prices will be “normalised” by 2006. And at last it is starting to talk of launching an energy-saving campaign.

These are welcome, if very belated, signs of pragmatism. They also vindicate the many officials who in vain warned the president of the impending crisis. Roberto Lavagna, the economy minister, first wanted to increase tariffs under Mr Duhalde, then tried again last year. But more action is needed to make sure Argentina's lights stay on.

The investments required are large: perhaps $500m a year in electricity generation, a similar sum in transmission and distribution, and hefty amounts to ramp up gas exploration and ease pipeline bottlenecks. All that will require a clear regulatory framework (something Mr de Vido has seemed in no hurry to provide). The one left by Mr Menem needs tweaking: it gave insufficient incentives for investment in the transport of both gas and electricity. On one point, there is surprisingly broad agreement: Argentina needs a single energy regulator, staffed by engineers as well as economists. And Argentina's politicians need to let them get on with their job.

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Peru's coca farmers

Always coca

Apr 22nd 2004 | LIMA
From The Economist print edition

Going straight is hard to do for coca farmers in Peru

Reuters

Thirsty work

Get article background

PERU'S coca farmers think they have an unfairly bad reputation. The plant that they cultivate, they argue, has many harmless applications, such as making invigorating coca-leaf tea. Only half of the coca grown in Peru is used to make cocaine, according to a federation representing the country's 50,000-odd coca-growers. President Alejandro Toledo's government maintains that the true figure is more like 90%.

Two months ago, the planters gave the government an ultimatum: stop trying to eradicate coca, abolish the national anti-drug agency and draft a “coca law” to make it easier to put the leaf to industrial use, by April 20th—or else. The government ignored them. So the growers have begun setting up road blocks in their backwater towns. Unless Mr Toledo starts yielding, they plan to march on major cities in the next week or two.

Their cause has received a pick-me-up from Vortex, a soft drink with a Peruvian twist, namely that it is made with coca extract. Advertised as a “coca energy drink”, Vortex was launched in February by Amadeus Corporation, a local firm. It contains no actual cocaine: the offending alkaloid, one of around 14 in the coca leaf, is removed as part of a secret formula. The drink is flying off the shelves as fast as the company can bottle it. It racked up $350,000 in sales in its first eight weeks, nearly a 5% share of Peru's burgeoning energy-drink market.

But Amadeus cannot export its product, because the coca leaf is banned everywhere except Peru and Bolivia. The United States, the only country to make an exception, allows one New Jersey-based firm to import 100 tonnes or so of dried coca leaves each year for use in a variety of products. But that is no help to Vortex. Christian Chang, Amadeus's founder, argues that he should be allowed to sell his drink abroad, and that coca is a traditional crop that has been discredited by drugs-traffickers. He says he wants to compete with another, somewhat larger firm that once used coca in its beverages.

Peru's coca farmers applaud Mr Chang: lobbying Congress in February, they held up bottles of Vortex as evidence. But the Peruvian government, urged on by Washington's drug warriors, is evidently unimpressed. It has pledged to eradicate most of Peru's 77,000 acres of coca by the end of next year.

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Haiti

After the fall

Apr 22nd 2004 | MIAMI
From The Economist print edition

Is Haiti getting better?

Get article background

THE American-led stabilisation force is more than half way through its 90-day mandate in Haiti, following the fall of President Jean-Bertrand Aristide in February. The UN is due to take over in June. So is Haiti recovering from the pandemonium?

Up to a point. A semblance of order has returned, but many of the rebel leaders who launched the uprising continue to roam the country with their weapons. They had pledged to disarm once Mr Aristide was gone, but many have not. American commanders insist that disarmament is not part of their remit, and limit their operations to securing key installations and helping to sweep the streets of rubbish. Despite early talk of a weapons “buy-back” programme, barely 150 guns have been turned in so far.

Meanwhile, supporters of Mr Aristide complain of a witch-hunt by the new interim government. Amnesty International says at least four of the ex-president's associates have been kidnapped, and other citizens have been attacked and harassed.

And allegations have emerged about the role of the Dominican Republic, Haiti's neighbour, in the uprising. “They didn't give us any guns, but they gave their backing,” says one rebel source. The theory is that Dominican generals wanted a military rival next door to justify their own budget (the Dominican armed forces are one of the largest in the hemisphere on a per capita basis). There are also questions about how much the Americans knew about this collusion. A Pentagon official conceded that a rebel military camp on the Haitian-Dominican border was identified a year before the revolt began. Critics say the Americans could easily have snuffed out the plot by leaning on the Dominican government, but that—although there were some pretty disreputable characters in the rebel ranks—they chose not to.

What about the future? Though American troops will soon be pulling out, Haiti's fortunes will still partly rest on the extent of Washington's largesse. So far, the United States has pledged only $55 million for Haiti, far less than was once anticipated.

The country will need manpower as well as money. Kofi Annan, the UN secretary-general, this week called for a new stabilisation mission, involving some 6,700 troops and over 1,600 international police and experts (the current force contains only 3,600 soldiers, more than half of them Americans; the rest are French, Chileans and Canadians). Reginald Dumas, Mr Annan's envoy to Haiti, says the international community needs to make a 20-year commitment to prevent the country sliding back into violence yet again.

The rebels have their own agenda. They and their allies have already been allowed to fill municipal positions left vacant by fleeing supporters of Mr Aristide's Lavalas Family party. Their next goal could be the reconstitution of the Haitian armed forces, as the Dominicans allegedly intended. Herard Abraham, a retired general and Haiti's new interior minister, is sympathetic. Mr Aristide disbanded the army in 1994, after it had ousted him in 1991; several former army officers were among the rebel leaders. Some of them are now demanding a decade's worth of back pay.

Human-rights activists fear a new Haitian army would guarantee the impunity of criminals. The Americans argue that Haiti doesn't need an army. But if they and the rest of the world look away, as they have done in the past, the rebels may get their way again.

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Ecuador

Not so loco

Apr 22nd 2004 | QUITO
From The Economist print edition

After some improbable success, Ecuador's president may be in trouble

Get article background

Reuters

I do the coups around here

WHEN Lucio Gutiérrez took office as Ecuador's president in January 2003, the omens were inauspicious. A former army colonel and coup leader, he had little political experience and few allies. Social protests and a whiff of drug money threatened to make his premiership even briefer than those of his two elected predecessors, both of whom lasted less than 18 months. It now seems possible that scandal and political isolation will indeed bring him down. Yet, on the face of it, Mr Gutiérrez has done an improbably good job.

First, the good news. After decades of economic instability—and in spite of fears over the sustainability of Ecuador's hasty switch to the dollar four years ago—GDP grew by an estimated 2.7% last year. The public finances were in the black; inflation dropped to a record low of 6%; foreign investment reached a record high; the trade account was almost in balance.

To be sure, luck has played a part in this success. The price of oil—Ecuador's top export, and the government's second source of income after taxation—is high. Interest rates in the international markets are low, easing the cost of debt. The weak dollar has buoyed exports. Some consequences of previous travails have also proved beneficial: Ecuadoreans who left in droves following the economic crisis of 1999 have been sending lots of money home. Last year's remittances were estimated at $1.5 billion, or 5.6% of GDP.

But some credit must also go to Mr Gutiérrez. Under the guidance of Mauricio Pozo, the finance minister, his fiscal discipline has, until now, been strict. This year, for example, they are setting aside around $340 million to buy back debt. Negotiations will soon begin on a free-trade agreement with the United States, which will be a big fillip if the small-print is right.

The domestic benefits have been unspectacular but real. Ecuador remains one of the poorest countries in the region; over half its population is thought to live below the poverty line. But the plight of the urban poor, in particular, has eased since dollarisation. Inflationary money-printing binges are now impossible, and real wages have stabilised or even increased.

This silver economic lining does have an accompanying cloud. Oil is driving almost all the growth and foreign investment. Despite ongoing disputes between Mr Gutiérrez and the oil companies—plus the recent resignation of the energy minister and allegations of mismanagement—investment and production have risen. But a drop in prices would be traumatic.

Meanwhile, the rest of the economy, struggling to remain competitive under dollarisation, is stagnating. And the government has neglected the structural reforms required to make dollarisation work in the longer term and to maintain the support of the IMF (whose last loan deal expired this week). For example, the electricity and telecom industries remain state-dominated; their inefficiency drains government resources and results in inflated rates. The Fund will be especially alarmed if the government succumbs to recent pressure for a hike in public-sector wages, at the expense of debt repayments.

But scandal, and political manoeuvring, are Mr Gutiérrez's immediate worries. A sensible cabinet

reshuffle in December brought in Raúl Baca—a grandee with links to poor Indian farmers and trades unions—as interior minister. He has softened the president's confrontational demeanour. Still, as tends to be the case in Ecuador, Mr Gutiérrez is dependent on the parliamentary support of others, in particular the centre-right Social Christian Party (PSC), a notoriously fickle and self-serving bunch. Although it co-operated with changes designed to cut the public-sector wage bill last year, the PSC is less likely to support other needed reforms.

And they and the president's other rivals are smelling blood. Mr Gutiérrez still stands accused of receiving—and lying about—campaign donations from a Mexican political party. Even if he survives the ongoing investigation, his fair-weather allies will not want to look like his patsies in advance of the local elections due in October. Under Ecuadorean law, the president's Patriotic Society Party must win more than 5% of the votes to remain on the electoral register, having failed to reach that target in the last congressional poll.

So the whirligig of Ecuadorean politics might yet dislodge Mr Gutiérrez before his time. Yet he might still see off the scandal and scrape together enough votes to survive. If he does—and if the oil price remains high—Ecuador could still enjoy some unwonted stability.

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Indonesia

Ready for the big one

Apr 22nd 2004
From The Economist print edition

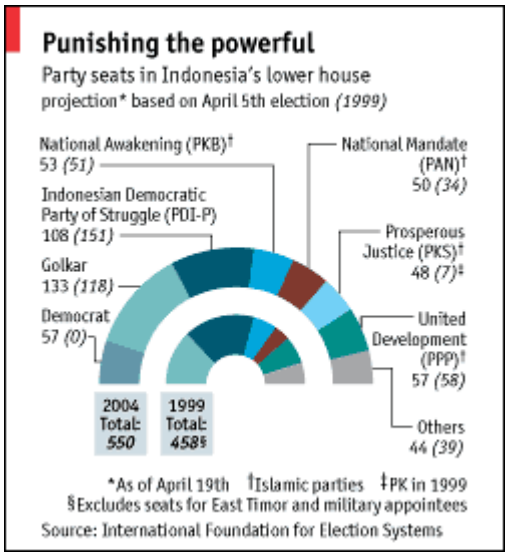
Reuters

The final results of Indonesia's most recent election have yet to be announced, but could Susilo (above) win the next one?

Get article background

A FEW Muslim leaders, a housewife-turned-politician, an indicted war criminal and another, less controversial, general—the candidates for Indonesia's first-ever direct presidential election are gradually lining up. In another week or so, when the last returns from April 5th's parliamentary poll finally trickle in from the farthest-flung islands of the archipelago, parties will officially nominate their tickets for president and vice-president. But they are already poring over the partial results for clues as to how different pairings might perform, and choosing their candidates accordingly.

The most surprising choice so far is that of Golkar, the party that dominated Indonesia's rubber-stamp parliament until democratic reforms led to free elections in 1999. At a special convention on April 20th, it chose Wiranto, a former army chief, as its presidential candidate. Although some Indonesians perceive him as a strong, decisive and patriotic leader, many others associate him with the corruption and brutality of Suharto, the country's former strongman. Foreigners remember the general chiefly for failing to stop, if not for actually instigating, the bloody mayhem that engulfed East Timor after it voted to separate from Indonesia in 1999. A United Nations-backed tribunal indicted him last year for his role in the violence, and America has made discouraging comments about his candidacy—but no Indonesian court has tried him for any wrongdoing, let alone convicted him. Golkar's leaders, apparently, considered Mr Wiranto's chequered career less of a liability than the corruption scandals dogging his rival, Akbar Tandjung.



By snatching Golkar's backing from Mr Tandjung, the party leader and architect of its selection process, Mr Wiranto proved himself a well-funded, persuasive and determined campaigner. Since Golkar is leading in the parliamentary election, with roughly 21% of the

votes, he looks like a serious contender. But voters will not necessarily opt for the same party in the presidential election as they did in the parliamentary one. What is more, until now, Mr Wiranto's support has not reached double digits in any opinion poll.

Instead, most polls put another former soldier, Susilo Bambang Yudhoyono, in the lead. Although he, too, was a top general during Mr Suharto's final years in office, he is best known as a former minister, spokesman and trouble-shooter on terrorism and security for the current, democratic government. His newly founded party, the Democrats, made bigger gains than any other in the parliamentary elections, winning 8% of the vote. His running mate, Jusuf Kalla, is another former minister and businessman, who has helped to broker peace accords between feuding Christians and Muslims in several of Indonesia's most restive provinces. Better yet, the ticket straddles Indonesia's main ethnic and ideological divides, since Mr Susilo is Javanese and secular in outlook, while the pious Mr Kalla comes from Sulawesi, one of the outer islands.

Megawati Sukarnoputri, the current president, appointed both Messrs Susilo and Kalla to the cabinet. The defection of such senior lieutenants leaves her campaign for re-election looking increasingly beleaguered. Her Indonesian Democratic Party of Struggle (PDI-P) saw its share of the vote plunge in the parliamentary election, from 34% in 1999 to 19% now. Voters do not seem to give Miss Megawati credit for stabilising the economy and blame her for high poverty and unemployment.

Nor do the prospects look good for Amien Rais, the most prominent Islamic candidate. His National Mandate Party won only 6% of the vote in the parliamentary elections, although he himself scores more highly in most opinion polls. Another Muslim leader (and a former president), Abdurrahman Wahid, has said he will also stand, although he might be barred from running on medical grounds. Two other big religious parties have yet to endorse any candidate.

The election, scheduled for July 5th, is still well over two months away. Many voters remain undecided. The dynamics of the race could change profoundly if, say, the various Islamic parties were to agree on a single ticket, or if Miss Megawati were to choose an inspirational running mate. What is more, the contest will go to a run-off on September 20th if no candidate wins more than 50% of the vote. That leads to all sorts of complicated calculations about the likely winner, depending on which two candidates make it to the second round. A contest between two ex-generals, unsavoury though that might seem, is by no means to be ruled out.

Still, the results of the parliamentary election do provide one obvious pointer to the presidential hopefuls: the electorate is in an anti-incumbent mood. In 1999, the top five parties secured 87% of the vote. This time, those same parties managed only 68%. Instead, a host of smaller, untested parties have made gains, including Mr Susilo's Democrats and the Prosperous Justice Party, an Islamic outfit that emphasises clean government. Yet Mr Susilo also faces a daunting challenge in campaigning as an outsider. He must find a way to spread his message beyond his relatively rich, educated and urban following to the mass of poor, rural voters. That requires a political machine he does not have—yet.

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South Korea

The comeback kid

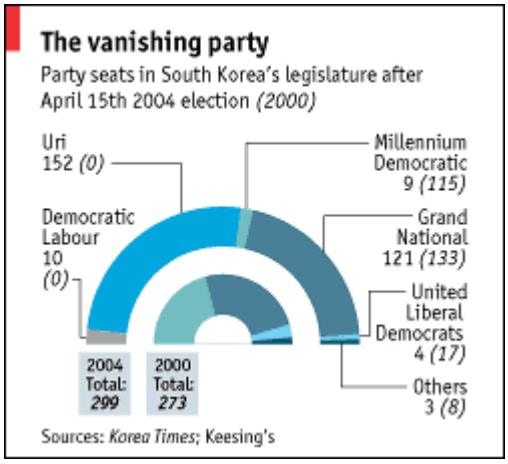
Apr 22nd 2004 | SEOUL
From The Economist print edition

With a new parliamentary majority, Roh Moo-hyun awaits a second chance

Get article background

THE voters have spoken; now it is the judges' turn. This week, after an exciting general election on April 15th, all eyes turned back to South Korea's Constitutional Court, which must decide what role Roh Moo-hyun will play in the nation's generational and ideological wars. Its nine judges could make the president a political martyr, by upholding the charges on which his opponents impeached him last month; or they could give Mr Roh his job back, and let him try governing with a majority for a change. Either way, after last week's victory by the Uri party, which backs Mr Roh, politics in South Korea is about to get interesting.

Most South Koreans expect the judges to restore Mr Roh to office. Formally, the court must rule on charges that the president committed a technical violation, by praising the Uri party before the election campaign. But the charges struck most South Koreans as flimsy and politically motivated: seven out of ten say that they opposed impeachment. This issue helped the party to triple its representation by winning a majority (152) of parliament's 299 seats. The Millennium Democratic Party—the party of Mr Roh's predecessor, Kim Dae-jung, which sponsored the motion—was nearly wiped out, winning only nine seats. The conservative Grand National Party lost its majority.



If he does regain his job, as expected, how will Mr Roh exploit his hard-won legislative clout? Many of his young, anti-establishment supporters hope that the president will now shift the country leftwards. These reformists consider South Korea's brand of democracy to be corrupt, outdated and unfair. They resent the economic and political dominance of giant family-controlled business conglomerates, known as *chaebol*; many of them also resent South Korea's closest ally, the United States.

Mr Roh, however, may disappoint by seeking a more pragmatic middle ground. He knows that Uri's victory owed less to support for himself or the young firebrands than to the incompetence and foolishness of the established parties. Before parliament impeached him last month, Mr Roh's approval ratings had fallen well below 40%.

Mr Roh can only blame so much of this on the opposition. The absence of a parliamentary support base clearly hampered him during the first year of his term, which began in February 2003. But Mr Roh's political inexperience and chronic indecision also hurt him. His handling of economic policy has been especially rudderless. But if he does choose the pragmatic route, and cuts down on the fumbling and indecision, Mr Roh could now make some lasting reforms during the remaining four years of his term.

His most important task will be to follow through on pledges to make the *chaebol* more open and accountable. Mr Roh has already taken steps to overhaul the prosecutor's office, and several financial investigations of *chaebol*-linked businesses are moving through the system. During his first year, however, the president sent mixed signals about whether he was eager to pursue prominent cases of corruption and fraud. He appeared to hesitate partly out of political weakness and partly for fear that too many scandals would upset the economy, which the *chaebol* dominate. If Mr Roh now presses prosecutors to pursue these cases without prejudice, he can delight his party while striking an important

blow for reform.

South Korea's aggressive labour unions may prove a tougher test. Mr Roh, a former labour lawyer, handled labour problems dismally during his first year, responding inconsistently to a series of crippling strikes. If he is to avoid a similar disaster, he must come up with a clear policy on business-labour issues, and then show some resolve.

Relations with North Korea and America, of course, will also test Mr Roh. As an activist he opposed America's military presence in South Korea, and when he took office he seemed eager to placate North Korea. The president quickly moderated this line, and showed signs of co-operating with America during his first year. Uri's success, however, may exacerbate tensions in the alliance.

Big business, big labour and the big, bad United States: when Mr Roh, a relative unknown, took office a year ago, the world wondered whether the former activist would prove a radical leftist on these three issues. If the judges give him his job back with a majority in parliament, a true picture of Mr Roh will at last start to emerge.

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China and North Korea

Heads together

Apr 22nd 2004 | BEIJING AND WASHINGTON, DC
From The Economist print edition

Can China coax North Korea out of its nuclear corner?

AP

Get article background

THOSE seeking to confirm reports earlier this week that North Korea's boss, Kim Jong Il, was in a secret huddle with China's leaders could do little more than stake out swanky Beijing restaurants (the reclusive Mr Kim is something of a foodie). Only after his special train had pulled out again did China's news agency acknowledge that Mr Kim and China's president, Hu Jintao, had agreed "to continue jointly pushing forward the six-party talks process". Does that mean there will be a breakthrough in diplomatic efforts, which also include America, South Korea, Japan and Russia, to end the threat from North Korea's nuclear tinkering? It would not come a moment too soon.

China has long been ambivalent both about how much influence it can exert over its prickly neighbour, and about what nuclear capability North Korea really has. But America's vice-president, Dick Cheney, turned up in Beijing last week with new details from Abdul Qadeer Khan, the Pakistani scientist recently fingered for selling nuclear secrets abroad, about potentially militarily useful uranium-enrichment help that he sold to North Korea; on one visit Mr Khan also says he was shown three, presumably plutonium-based, nuclear devices. As Mr Cheney pointed out, time may be running out for diplomacy.

China evidently pressed Mr Kim to show some flexibility in a third round of six-party talks that are supposed to take place before July. According to South Korean press reports, China's former president, Jiang Zemin, sought to reassure Mr Kim, who complains of America's "hostile attitude" as justification for hanging on to his "physical deterrent", that an American attack on his country was highly unlikely.

South Korea is keen to explore the idea of a freeze on North Korea's nuclear activity as a first step—and both South Korea and China have suggested that more food and energy aid could be provided if North Korea agrees. For their part, American officials insist that any such freeze be comprehensive in scope—covering both ongoing plutonium production and the newer uranium-enrichment programme—and limited in time, so as to prevent North Korea dragging its feet indefinitely over the "complete, verifiable and irreversible" dismantlement of its nuclear programmes that the other five accept is their aim.

Hopes that North Korea will acquiesce in that too rest in part on its needy economy. China's prime minister, Wen Jiabao, reportedly recommended to Mr Kim this week that he take a look at South Korea's reforms, as well as China's. While pocketing hand-outs from China, he would also do well to look at the burgeoning links his hosts have had with South Korea since the two established formal diplomatic ties in 1992. Bilateral trade has gone from $6.2 billion a year to close to $60 billion, making China, in some months, the biggest market for South Korea's exports. Korean officials think trade could top $100 billion by 2006. More of South Korea's investment flows into China than anywhere else.

Tempting, for a country that has lost perhaps 2m of its citizens to famine and related causes since the mid-1990s? Perhaps. But, watching South Korea's recent rough-and-tumble politics, Mr Kim has been less than impressed. If he concludes that hanging on to his nuclear weapons is the only way his regime can survive the pressures of the world outside, then diplomacy may not be enough.

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The Philippines

The star and the economist

Apr 22nd 2004 | MANILA
From The Economist print edition

A dirty campaign

Get article background

OPINION polls in the Philippines suggest that the presidential election on May 10th will be a tight contest between the incumbent, Gloria Arroyo, and the opposition leader, Fernando Poe. Mrs Arroyo, a highly-educated economist, will have to convince voters she can improve on her disappointing record in government thus far. Mr Poe, on the other hand, is a secondary-school drop-out and political newcomer. But he is a famous film actor who feeds a popular yearning for heroes, even fictional ones. Following a campaign rich in lawsuits and mudslinging, a close election could severely test the Philippines' 18-year-old democracy.

Mrs Arroyo needs a popular mandate. She owes her current job to an uprising, which overthrew President Joseph Estrada in 2001 and propelled her from vice-president to the top job. Her campaign has focused on policies for providing water, electricity, health care, education and employment to the legions of Filipinos who have few or none of these. Mr Poe—whose supporters include Mr Estrada, now on trial for corruption, and many of the politicians who backed the former president—has plenty of personality but appears disinclined to talk about policies. His programme, if there is one, remains a mystery (with the exception of a vague wish to restore public trust in government) and he has refused to appear in a televised debate with Mrs Arroyo.

The president accuses the opposition of resorting to mudslinging as a substitute for policies. The opposition has initiated a series of lawsuits seeking to have Mrs Arroyo disqualified on the ground that she is using government resources for her campaign, an accusation she denies. Dirty tactics, however, have been used by both sides. Early in the campaign, there was an unsuccessful attempt to have Mr Poe disqualified, arguing that he is the illegitimate child of an American mother and therefore not a Filipino.

The tone of the campaigning, and the prospect of Mrs Arroyo losing, have dismayed many businessmen. Since the beginning of the election season, the stockmarket has been volatile, and the value of the peso has sunk to record lows.

The inability of the election authorities to carry out reforms of the vote-counting process means the ballots will be tallied by a laborious method which takes days or even weeks to produce a result, and which is vulnerable to abuse. Accusations of vote-rigging are customary, and the more closely contested the election, the more strident such accusations are likely to be. Mrs Arroyo scoffs at worries of violence, saying Filipinos have the political maturity to accept a close result. But she cannot have forgotten that she became president by dint of civil unrest not so long ago.

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India's election

In the name of the father

Apr 22nd 2004 | AMETHI
From The Economist print edition

The new Gandhi generation

THERE aren't many statues of Rajiv Gandhi, the Indian prime minister assassinated in 1991. But there is one on a small crossroads in Amethi, a dusty run-down town in the north Indian state of Uttar Pradesh. For over 25 years, the town has been a stronghold of the Gandhi dynasty, which has dominated the Congress party since 1947. The statue is a reminder of the town's moment of glory, when Mr Gandhi was its member of parliament. But Amethi has declined since then, along with the national fortunes of Mr Gandhi's Congress party, which has not been in power since 1996. Left behind by India's economic development in the past decade, it has none of the internet booths and electronics showrooms that have sprouted across the country, nor any evidence of the “India Shining” theme that the governing Bharatiya Janata Party (BJP) is pushing in the country's current general election.

Reuters

The Priyanka and Rahul show

Now the Gandhis are using the area, whose 4m voters go to the polls on April 26th, as a launch-pad for their political dynasty's next generation. The party's general-election candidate there is Rahul Gandhi, Rajiv's 33-year old son, who is making his political debut after spending most of his 20s abroad. His Italian-born mother Sonia, Rajiv's widow and the president of Congress, is the local MP but is moving to neighbouring Rae Bareli, another family stronghold. Satish Sharma, a family friend and veteran MP, says he is keeping the nearby seat of Sultanpur warm for Priyanka, Rahul's charismatic 32-year-old sister, who has yet to enter full-time politics.

The rejuvenation of the Gandhi clan is hardly surprising in a country where there is almost unquestioning acceptance of political dynasties. Rahul Gandhi is being feted wherever he goes as the reincarnation of his father. He is considered a likely future leader of Congress, which has never functioned for long without a Gandhi or a Nehru in charge. Some Congress leaders say privately that Sonia Gandhi should step aside and help the party mount a more effective opposition to the BJP.

Sonia Gandhi was pulled into active politics in the late 1990s to rebuild the party's morale, which she did successfully. But she has little political experience, has failed so far to increase the Congress vote-bank, and is not regarded as a viable prime ministerial candidate. Rahul has even less experience but is a better long-term prospect. With characteristic modesty, he stresses that his first priority is Amethi, where he and Priyanka help run charity-based micro-credit and computer education programmes.

“I've not come as a politician but as a son and a brother,” he tells people. His agenda, he says, is to “tackle the bigotry” in India that “divides caste and class against each other”. Friends of the family liken

that to his father's (unsuccessful) ambition in the 1980s to steer India away from increasingly corrupt and self-serving governance. At any rate, it looks as though he and his sister might grow into a powerful political double-act. Certainly the BJP seems rattled by the family trio. It is attacking Sonia's foreign origins with some success, but finding it much harder to ridicule Rahul and Priyanka.

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Pakistan's tenacious president

Third time lucky?

Apr 22nd 2004 | LAHORE
From The Economist print edition

No retirement in sight

Get article background

PERVEZ MUSHARRAF, Pakistan's president, has at last got what army chiefs before him have always coveted: a National Security Council (NSC). Before the bill became law on April 19th, the opposition walked out in protest following the government's refusal to allow scrutiny of the bill, which was passed in less than four minutes. General Musharraf, who argues that “the military can only be kept out by bringing it in”, insists that the NSC will be a consultative body only. But many fear it will entrench the political power of the armed forces—and of the general himself.

The 13-member body will include four military members besides General Musharraf, who will chair it. Other council members include the prime minister, the four provincial chief ministers, the speaker of the parliament, the leader of the opposition and the chairman of the Senate. The president has the power to sack the prime minister and parliament, and the provincial governors he appoints can sack the chief ministers. So the general has a lock.

At the end of last year, the Muttahida Majlis-i-Amal (MMA)—an alliance of religious parties with the third-biggest block of seats in parliament—joined hands with the ruling Pakistan Muslim League-Quaid party (PML-Q) to amend the constitution, legitimising the general's 1999 coup and increasing his powers. In exchange, a clause was inserted holding him to his promise to hang up his army chief's hat by December 31st.

But when recently confronted by the BBC, Mr Musharraf refused to confirm that he would relinquish his military job. This has led to speculation that he may abrogate the constitution, sack parliament and order fresh elections, or lean on the Supreme Court to help him out of his obligation.

On April 17th, Mr Musharraf declared he would not allow two exiled former prime ministers, Benazir Bhutto and Nawaz Sharif, to return, and exhorted his supporters to unite and get ready for local and then general elections. Pundits expect that his next step will be to become the leader of a united PML.

The strategy is hardly original. Two former military rulers, Ayub Khan and Zia ul Haq, followed much the same route. When they fell, the systems they manufactured crashed too, forcing Pakistan to start all over again.

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Iraq

Is it war, or peace?

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From The Economist print edition

Reuters

Neither, yet. But either is possible

Get article background

NO SOONER have the Americans quenched one fire than another flares up. After partial ceasefires were negotiated in Fallujah, the Sunni town of a hundred minarets, and in the Shias' holiest city, Najaf, insurgents attacked marines in Qaim in the far north, and in Diwaniya, a previously quiet southern town near Najaf. When these two skirmishes finished, fighting began again in Fallujah. America's military might alone does not seem enough to impose peace on Iraq.

More than 100 American soldiers have been killed this month, the highest toll since they first occupied Iraq. In the southern city of Basra and in a nearby town, rebels this week killed at least 68 Iraqis with car bombs that went off outside a police academy and three police stations whose officers had remained loyal to their British masters in the recent southern uprising.

American forces declared the main roads into the capital to be closed military zones and said drivers who used them would be deemed hostile and possibly shot. “We're a conquering army,” explained an American colonel. Iraqis are increasingly inclined to agree.

Initial support for America's assault on Fallujah, to blast out the car-bombers presumed to be sheltering there, has turned to horror, as stories of “collateral damage” have trickled out. After two weeks of siege, the Americans agreed to let the people of Fallujah bury their hundreds of dead and ferry the injured to hospital. Fifty of the thousands of displaced families are also to be allowed back to their homes every day. But the American defence secretary, Donald Rumsfeld, gave warning that his men would attack again if the rebels did not comply with American terms, which include the surrender of their heavy weapons. On April 21st, the shooting resumed.

America is turning friends into rebel sympathisers, and sympathisers into activists. Over the past week, several leaders of the mystical Sufi trend of Islam, hitherto favoured for its apolitical approach, called on their acolytes to join or help the *jihad*.

A heavy hand makes heavy work

The Americans decline to reveal their rules of engagement. But British officers argue that they are being too heavy-handed, especially in Fallujah. “You cannot deal with an insurgency by collective punishment,” says a British officer. Saddam Hussein would have disagreed, of course, but America holds itself to higher standards.

Many people think that non-military means for pacifying Iraq are being neglected. “You have to resolve it politically,” says a Sunni on the American-appointed Governing Council (GC). In an effort to broaden its power base, the council is soon to convene the first of a series of “big tent” meetings. Among the 2,000-odd invited are some followers of people previously described by the Americans as outlaws and terrorists. Delegates are being offered only a consultative role; it is unclear how many will actually show up. Iraq's American proconsul, Paul Bremer, is apparently worried that General John Abizeid, the top American general in the region, may be doing more harm than good.

This week, the Americans appointed a former Amnesty International staffer to run a media commission to preside over “the freest media in the Middle East”. But media freedom took a knock when American troops mistakenly shot dead an Iraqi journalist working for an American-funded television network, Iraqiya, as he drove to Samarra, a town north of Baghdad where Sunni leaders say anti-American anger runs second only to Fallujah.

The revolt has paralysed reconstruction. After the abduction of 12 of their colleagues last week, 350 Russian, 70 German and 20 American electrical engineers have reportedly packed their bags. The electricity ministry is fretting. As the scorching summer nears, who will repair the power stations that cool rooms and tempers?

Iraq's political reconstruction is also imperilled. After seeing three of his programmes for transition binned, Mr Bremer is unwilling to stake his credibility on a fourth. While he focuses on assembling a coherent civil service in time for the formal handover of power to Iraqis on June 30th, America has delegated the task of selecting a government to Lakhdar Brahimi, the UN's Algerian-born envoy to Iraq.

President George Bush has made much of this UN involvement. But Iraq is still far from being a UN responsibility. Mr Brahimi's plan, presented on a recent visit, is for a depoliticised government of technocrats to run the country for six months and prepare for elections in January. An advisory national council may be appointed but it would be a talking-shop for politicians to let off steam, not a real legislature.

Iraq's politicians, fearful of being sidelined, are champing. Only last month, the GC's 25 members were relishing the prospect of forming Iraq's first sovereign government since Mr Hussein's fall. Now, thanks to Mr Brahimi, they feel further from power. In their anger, supporters of Ahmed Chalabi, a would-be prime minister long favoured by American hawks, are denigrating the UN envoy for alleged closet Baathist sympathies, among other failings. Not only was he against the war in 1991 to oust Iraq from Kuwait; he disapproves of deBaathification (indeed, he has argued that it has stripped Iraq of competent officials as well as thugs). How can you trust the UN, asked a spokesman for Mr Chalabi, after continuing revelations about the UN's oil-for-food programme, which Mr Hussein apparently abused to bribe those he thought could help him?

Many Iraqis fear that even after the handover, America will still pull the strings. In terms of providing security, no alternative has yet emerged. Last month the GC agreed that American generals should retain command of Iraq's security forces after June 30th. Mr Bremer noted this week that Iraqi policemen ran away when faced with armed rebels, so they will need the coalition's help. What worries some Iraqis, however, is that there is no hint yet of a date for the American troops' eventual departure. A British general suggests his forces may stay ten years.

A lot of passport officers

America will also still control the bulk of Iraq's capital budget, largely funded by American taxpayers. Under its incoming ambassador, John Negroponte, the American embassy is to have more staff than the coalition authority does now. Wamidh Nadhmi, a politics professor at Baghdad University, asks, somewhat facetiously, whether America really needs 4,000 diplomats to issue visas.

Most Iraqis still want American help. Many were dismayed when a rebel cleric, Muqtada al-Sadr, hailed this week's peremptory withdrawal of Spanish forces from Iraq as a victory, fearing that other countries' troops may rush home too. That, they know, could spell chaos.

But since Fallujah's siege, more Iraqis are asking whether coalition forces are part of the solution or part of the problem. Pilgrims contrasted Mr Sadr's policing of a recent holiday in Karbala, when no one was killed, with that of Ashoura, a holiday overseen by the Americans, when bombs killed 150. Some suggested they would be safer without the coalition. When British troops came to inspect this week's carnage in Basra, they were pelted with stones.

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Saudi Arabia

Bin Laden hates Saudis, too

Apr 22nd 2004 | CAIRO
From The Economist print edition

Another terrorist outrage jolts Saudi complacency

Get article background

EPA

The forces of evil strike again

THEIR country may seem an oppressive place to outsiders, but Saudis have long preferred to see it as a haven of wholesome family living and safe streets. Another huge suicide bomb this week battered that comfortable self-image. Exploding outside a police headquarters in central Riyadh, it killed at least four people and wounded some 150. It was the latest of a series of outrages.

When Saudis first learned that most of the hijackers of September 11th 2001 were their countrymen, they shrugged it off. Those killers were oddballs, they said, and their anger against American policy was understandable, if perhaps exaggerated. Such complacency was shaken by al-Qaeda suicide bombs that killed 52 people in Riyadh last year. Yet some Saudis still argued that although the bombs killed some Arabs and Muslims, the intended victims were westerners, which was not so terrible, because their governments had invaded Muslim lands.

The latest attack, however, was a direct assault on the Saudi state. It shattered a six-storey building said to be used by the traffic police, in a district packed with other state institutions. The damage could have been even worse: guards stopped the vehicle outside a perimeter fence.

More disturbingly, Saudi security forces claimed to have captured and defused no fewer than five similarly designed car bombs in the previous week. At least two were stuffed with some 1,400kg (3,000lbs) of ammonium nitrate, not much less than was used in the 1995 Oklahoma City bombing that killed 168 people. The two vehicles were found only by chance, when soldiers on desert exercises happened upon them parked in a rocky wasteland. Last week, the American embassy said that all non-essential staff would leave immediately and urged the estimated 15,000 Americans working in Saudi Arabia to go as soon as possible.

No one believes that terrorists are about to topple the Saudi state. Granted, frustration with feudalism is widespread. So, to a lesser degree, is admiration for Osama bin Laden, with his image of riches-to-rags piety. But the attacks on Saudi soil have curtailed whatever support al-Qaeda once had. And while it appears that Saudi terrorist cells are well funded, well equipped and well trained, their actions have so far been limited to a small part of the vast kingdom, stretching north from the capital to the conservative central region of Qasim.

That said, many Saudis worry about the effectiveness of the kingdom's police force. Hundreds of small fry have been rounded up since the first large bombing in Riyadh a year ago. But of the 26 prime suspects named by the interior ministry, 22 are still at large, despite bounties of up to $2m on their heads. In the past week, five police officers lost their lives in shootouts with wanted men, but only eight arrests were made. The Saudi authorities are at last taking seriously what Crown Prince Abdullah calls “the forces of evil”. But not before time.

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Iranian influence in Iraq

Tetchy neighbours

Apr 22nd 2004 | QOM
From The Economist print edition

Iran wants sway; America distrusts it

Get article background

IT WAS an anti-climax. Iran sent a mission to Iraq last week, avowedly to help the Americans resolve their standoff with Muqtada al-Sadr, Iraq's most prominent Shia Muslim rebel. The Americans received the Iranians coolly, though Colin Powell, America's secretary of state, had privately endorsed the mission. Unidentified assailants showed their appreciation by murdering an Iranian diplomat. But not everyone distrusts Iraq's neighbour.

America's British allies bridled when Donald Rumsfeld, the American defence secretary, recently accused Iran of “meddling”. If you ask the British, the Iranians are behaving. Iranian agents in Iraq are spying, as expected of a neighbour, but apparently not fomenting violence. Hizbullah, an Iranian-backed Lebanese group, may have removed its agents from Iraq.

It would be odd if the Iranians, who are Shias, like most Iraqis, were not trying to win friends across the border. They enjoy good relations with some members of Iraq's American-appointed Governing Council, and are cosying up to moderate Shia groups such as the Dawa party. Long before the uprising started, Mr Sadr, as the scion of a distinguished clerical family, was received by Iran's supreme leader, Ayatollah Ali Khamenei.

Mr Rumsfeld says that Mr Sadr gets Iranian cash. That may account for the restraining influence that Iran could perhaps exert over him. The Spanish government, for one, is thankful to Iran for helping to persuade Mr Sadr to rein in his fighters after they fired on Spanish troops in Najaf earlier this month. The Iranians, who were upset to be included in President George Bush's “axis of evil”, enjoy America's discomfort. But they also fear Mr Sadr.

In Qom, Iran's main seminary town, Mr Sadr's few supporters rally around Ayatollah Kazem Haeri, the cleric to whom, at least notionally, Mr Sadr defers in matters of theology and law. Mr Haeri's entourage complains that none of Iran's ten-odd grand ayatollahs has condemned America's recent shedding of Shia blood.

Racial discrimination

Race is a factor. The silent clerics regard Mr Sadr as a pan-Arabist bigot, and fear that he plans to end a long tradition of Iranian influence over Iraq's main Shia seminary, in the town of Najaf. They much prefer Grand Ayatollah Ali Sistani, Najaf's senior ayatollah, who is of Iranian origin.

Qom's future depends partly on events in Najaf. Half the 3,000-odd Iraqi clerics who took refuge in Iran for fear of Saddam Hussein are back home. So holy is Najaf that, given stability, Iranian clerics could follow. An exodus of senior ones to Iraq would embarrass Mr Khamenei.

Mr Sadr's anti-Iranian chauvinism, and his unpredictability, make him an impossible ally. But the choice is limited. For any Iraqi leader, too close an association with Iran is a liability. Mr Khamenei would love to have Mr Sistani, the grandest of all ayatollahs, in his pocket, but he is not co-operating. He disapproves of Iran's theocracy. Mocked by Mr Sadr's supporters for his Iranian accent and birth, he is keeping his distance from Iran's establishment.

Despite their current troubles, the Americans seem determined not to ask Iran for help. The Iranians have modest influence and a lot of local knowledge, but America mistrusts them. It is unclear whether the Americans warned Iran's delegation not to go to Najaf; in the event, the Iranians did not get close. A few days before the Iranian mission, one of Tehran's more reliable newspapers reported that American moves are afoot to have Iran's chargé d'affaires in Baghdad expelled.

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People-trafficking from Nigeria

Nigeria's other export

Apr 22nd 2004 | BENIN CITY
From The Economist print edition

A trade that cannot be curbed because so few Nigerians think it wrong

THE market in Benin City sells just about everything: ladies' pants and bras, plastic bags, padlocks and second-hand clothes known locally as “fairly used”. But this city in south-eastern Nigeria also thrives on a less wholesome trade: people-trafficking. Those who are trafficked are mostly young, female and destined to work as prostitutes in Europe.

No one knows how many are shipped out each year, but everyone in Benin City knows someone who has gone. The most popular destination appears to be Italy, where Nigerian girls in tight jeans can be seen lolling on many a street corner.

It is an organised and lucrative trade. The girls are recruited by local “sponsors”, who pay up-front for transport. The girls therefore start out thousands of dollars in debt. Before they leave Nigeria, they are taken to a witchdoctor and sworn to repay their debt and keep quiet. The shaman typically keeps a lock of their hair or some toenail clippings, and warns them that they will die if they break their oath.

Some are tricked: they believe they will work as hairdressers, or further their studies. Others know they will have to sell themselves, but are seduced by the prospect of more money than they could ever earn swabbing floors or tending yams back home. They leave Nigeria along well-established trading routes, often by road across the Sahara. Some end up in other west African countries. Others make it to Europe or Saudi Arabia.

A striking aspect of this dirty business is that it provokes so little moral outrage in Nigeria. On the contrary. Rita, an articulate young woman, was 16 when her mother sent her away to “work in Canada”. She found herself in Gabon (one of Africa's richest states) instead, where her sponsor, who said she owed her $45,000, ordered her to prostitute herself. She escaped and fled home. Her mother was furious. “She said I didn't want to make money for her. She said other girls go for three months and buy cars for their parents.”

It is a common refrain. Girls who repay their sponsors often do return home with cash to spare, which wins them the admiration of the community. “Everyone respects them,” says one 15-year-old girl in Benin City. “They have the best houses and the best cars; they are on top.”

Nigeria's international trade in people can be seen as an extention of domestic trafficking, which is rife. Poor families have traditionally sent boys and girls they have trouble feeding to work in wealthier homes. Sometimes, this is benign: a form of fostering that gives the child a better start in life. But sometimes it is thinly-veiled slavery. “They treated me like an animal,” says Iyagu, who became a domestic servant when he was eight. “If I didn't get enough fodder for the goats, they beat me.” Young girl-servants are particularly vulnerable to being raped by their employers.

In the most sinister cases, traffickers sell children to those who need body parts for pagan rituals. “Adam”, a headless, limbless boy fished out of a British river in 2001, came from near Benin City, and is thought to have been killed so that bits of him could be used for charms or curses, for which some Nigerians pay handsomely.

The Nigerian government admits that human trafficking is a problem. It banned it last year, and set up an agency to curb it. Local charities, some with help from outsiders such as Unicef, try to pitch in. But it is not an easy task. Laws in Nigeria are laxly enforced. Officials are often ignorant, or can be bribed to turn a blind eye. Most important, it is hard to stamp out a practice when so few Nigerians think it wrong. It seems that the country's get-rich-quick culture, fuelled by a generation-long oil boom, has trickled

right down to the bottom, unlike the oil money itself.

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Spain's new government

Waking up to reality

Apr 22nd 2004 | MADRID
From The Economist print edition

After his heady installation as Spain's new prime minister, the hard work for José Luis Rodríguez Zapatero is just beginning

“AND now to work, to fulfil commitments, to honour my word.” Thus José Luis Rodríguez Zapatero, on becoming Spain's fifth prime minister since the restoration of democracy after Franco's death in 1975. It was three days after Islamist terrorists struck in the Madrid train-bombings on March 11th that Mr Zapatero's Socialist Party won a surprise election victory; but, with just 164 seats, it was 12 short of an absolute majority in the Cortes, Spain's parliament. Last week, however, Mr Zapatero won parliamentary backing as head of a minority government by 183 votes to 148 (with 19 abstentions).

Mr Zapatero secured the support of 19 non-Socialist deputies, mainly from radical Catalan nationalists and the hard left. The mainstream Catalan nationalists and the Basque Nationalist Party abstained. But even such a loose alliance with nationalist groups that want greater autonomy from Madrid prompted a warning from the leader of the opposition People's Party, Mariano Rajoy, that this was “a weak and unstable government”.

Yet after the stifling dogmatism of José María Aznar's People's Party government, Mr Zapatero's arrival has brought a welcome breeze of change. “I will govern for all with respect and with humility,” he said. The mantra of this 43-year-old career politician, who trained as a lawyer but has never served in any senior government position, is “dialogue and consensus”.

In his most striking act, Mr Zapatero is to honour his campaign pledge to withdraw Spanish troops from Iraq. He is doing it faster than expected: within 24 hours of taking office he announced that the withdrawal would take place as soon as possible. The defence minister, José Bono, said this meant within six weeks. Why the haste? Because there was no prospect of the UN taking command in Iraq before or after June 30th (when formal sovereignty is to be handed over to an Iraqi government), said Mr Zapatero. America's George Bush rebuked him for his abruptness. Honduras, which has a small force under Spanish command in Iraq, is now also planning to withdraw its troops.

Beyond Iraq, Mr Zapatero has divulged little detail of his policy plans, but he has given strong hints of their likely direction. He has pledged to fight terrorism “in all its forms” and—perhaps to make up for the Iraqi withdrawal—to bolster the small Spanish contingent serving in Afghanistan. He wants to shift foreign policy to a more European line. He gave early backing to the draft European Union constitution. His foreign minister, Miguel Angel Moratinos, a former EU envoy to the Middle East who joined the

Socialist Party only shortly before the elections, has said that the Nice treaty, which gave Spain (and Poland) disproportionately generous voting weights, and which Mr Aznar defended to the hilt, “is not indispensable”.

Immediately after Mr Zapatero's installation, Mr Moratinos flew to Washington to try to smooth feathers ruffled over Iraq. He is offering non-military co-operation in Iraq, and help on reconstruction. But it is not clear exactly what this will amount to. Mr Zapatero himself is making his first overseas visit as prime minister to Morocco, with which Mr Aznar's government got on notably badly.

On the domestic front

Mr Zapatero has pleased Spain's restive regions by agreeing to consider “reasonable” modifications to the constitution. He has said he will oppose the so-called Ibarretxe plan, the Basque government's proposal to hold a referendum on the right of self-determination. But Mr Zapatero's first encounter with reality in the regions may come in Catalonia, if the radical nationalists, who are in partnership with the Socialists in the regional government, do not think his constitutional modifications go far enough. As another sop he has pledged to campaign for Catalan to be made an official EU language.

Mr Zapatero has also announced something of a social revolution. His government intends to change the law of male primogeniture to allow the Spanish crown to be inherited by a woman. He will relax abortion laws and tighten legislation on domestic violence. He also plans to reduce religious instruction in state schools, and to improve gay rights. Other electoral pledges, such as making more Spanish children bilingual by sending teachers abroad for a month to learn English, and reducing housing costs for young families by providing 180,000 subsidised homes every year, may run into financial obstacles. But one decision popular with greens was to scrap the national hydrology plan to siphon water from the River Ebro in north-east Spain to the parched south.

In marked contrast to Felipe González, a previous Socialist prime minister who was accused of taking the party for granted, Mr Zapatero will hold a weekly meeting with party bigwigs: the wheeler-dealing Alfredo Perez Rubalcaba, who will act as a parliamentary broker, and José Blanco, who will control the party. Within the cabinet, the key minister after Mr Moratinos will be Pedro Solbes at finance. Mr Solbes held the same post in Mr Gonzalez's last Socialist government, in 1993-96. He is credited with taking the first steps to prepare Spain's economy for the euro. As European commissioner for economic affairs, he was also a staunch defender of the euro area's stability and growth pact, which sets limits on budget deficits, so he is unlikely to be fiscally incontinent.

Mr Zapatero has promised that Spaniards' overall tax burden will not rise, but has also said that he will simplify the tax code as part of a programme to modernise the economy “so that well-being spreads to all.” Mr Solbes is, however, reported to have demanded “absolute power” to run economic policy. He inherits a bullish stockmarket and a content business community. But unemployment remains the highest in the EU, at 11.2%; and there are concerns about a potential property bubble and high debts that could turn into problems if euro-area interest rates rise.

The justice ministry has gone to the academic-minded Juan Fernandez Lopez Aguilar; the interior ministry to José Antonio Alonso, a magistrate and a personal friend of Mr Zapatero, who represents Leon, the prime minister's home town. Elsewhere, Spain's traditional cronyism seems to be at work, as Mr Zapatero places party nominees and favourites into a mass of official and semi-official jobs.

It was Mr Bono's inaugural speech as defence minister that was most at odds with the consensual spirit of the new government. Mr Bono said he would be proud to die defending his country against terrorists and false patriots. He fondly remembered his Falangist father and reaffirmed his Roman Catholic credentials. He accused the opposition of a lack of testosterone for not showing up to his investiture ceremony, and he harangued regional nationalists. The 53-year-old, who had been premier of the Castile-La Mancha region ever since 1983, was promptly dubbed outmoded and a fascist by his party's Catalan nationalist allies. As euphoria and optimism grip the left, these words of Mr Bono (caught by a television microphone earlier this year calling Britain's Tony Blair a “total dickhead”) provided a reminder of the tensions that may get in the way of Mr Zapatero's quiet revolution.

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Hungary and the Holocaust

The past reassessed

Apr 22nd 2004 | BUDAPEST
From The Economist print edition

The impact of a new museum in Budapest

AFP

Remembering on the rooftops

HUNGARIANS agree about little in their turbulent history. But on one issue they have been as one: that they bear little responsibility for the Hungarian Holocaust, in which over 500,000 Hungarian Jews were killed. This view may be challenged by the opening of the Holocaust Memorial Centre, based around a restored synagogue on Pava Street in the capital, Budapest, that was used as an internment camp in 1944.

The opening was attended by a host of dignitaries, including the prime minister, Peter Medgyessy, and his predecessor, Viktor Orban; from abroad came France's finance minister, Nicolas Sarkozy (who is of Hungarian descent), and Israel's president, Moshe Katsav. To add drama, a Budapest imam was arrested, with two Syrians, on suspicion of preparing a terrorist act against a Jewish target to coincide with the opening.

Until the Nazis invaded Hungary in March 1944, Hungary's 800,000 Jews had lived in comparative safety, hoping to escape the horrors all around. But the swift co-operation of Hungarian authorities facilitated the deportation of over 430,000 Jews to Auschwitz between May and July 1944. Most were killed on arrival. Others fell victim to roving bands of Hungarian Nazi Arrow Cross militia. Survivors talk of the shock of betrayal, and disbelief that the motherland would dispatch them to their deaths.

Yet despite this history, the post-war communists blamed the Holocaust solely on the Nazis plus a few Hungarian “extremists”. The confusion is shown in the Museum of Military History in Budapest, where two memorials pay homage to those who lost their lives in the second world war: one to Jewish victims, and another to paramilitary gendarmes who put them on the trains.

Hungary, which joins the European Union on May 1st, has one of Europe's largest Jewish communities, some 100,000-strong. Jewish cultural and religious life is reviving, at least in Budapest. But the country's image took a battering when its far right became openly anti-Semitic, prompting sometimes half-hearted denunciations from mainstream politicians. Today, as the new museum suggests, support for Jews is a rare point of consensus in Hungary's acrimonious politics. The former Fidesz government initiated a Holocaust Memorial Day. Writing in the *Magyar Nemzet* newspaper, Mr Orban described the Hungarian Holocaust as a “wound inflicted on the heart of the nation”, whose “mortification and shame still lingers”. A powerful message, for all its 60-year gestation.

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The Yugoslav war-crimes tribunal

By no other name

Apr 22nd 2004
From The Economist print edition

A definitive ruling that the Srebrenica massacre was genocide

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AP

Genocide mourned

CLAIMS that genocide was not committed in the 1992-95 war in Bosnia have been laid to rest. The five-judge appeal chamber of the International Criminal Tribunal for the former Yugoslavia (ICTY), led by an American, Theodor Meron, has ruled that the killing of some 7,500 Bosnian Muslims at Srebrenica in 1995 should be called by its proper name. “By seeking to eliminate a part of the Bosnian Muslims, the Bosnian Serb forces committed genocide,” Mr Meron said. “They targeted for extinction the 40,000 Bosnian Muslims living in Srebrenica, a group which was emblematic of the Bosnian Muslims in general...Those responsible will bear this stigma, and it will serve as a warning to those who may in future contemplate the commission of such a heinous act.”

The landmark ruling will affect the fate of others charged with genocide, including Slobodan Milosevic, the former Yugoslav leader, and two of his chief henchmen in Bosnia, Ratko Mladic and Radovan Karadzic, who are both still on the run. Of the three Bosnian Serbs so far tried for genocide by the ICTY, two have been acquitted; the third, Radislav Krstic, the general accused of orchestrating the Srebrenica massacre, has had his genocide conviction overturned on appeal.

The 1948 Geneva Convention defines genocide as “acts committed with the intent to destroy, in whole or in part, a national, ethnic, racial or religious group”. Although the court ruled that the main staff of the Bosnian Serb army had intended to commit genocide, it found no evidence that Mr Krstic ordered the killings or directly participated in them. He was found guilty instead of “aiding and abetting” genocide, and had his sentence reduced from 46 to 35 years.

The court could have a tough time proving genocide against Mr Milosevic too. Like Mr Krstic, he is not thought to have participated directly in the killings. Moreover, Serbia's reluctance to hand over vital military documents is hampering the case against him. International pressure is being brought to bear on the Serbian government, but as it relies on support from Mr Milosevic's own Socialist Party, it may well not co-operate.

Mr Milosevic's trial is due to resume on June 8th. It faced collapse after the presiding judge, Richard May, stepped down in February for health reasons, but Mr Milosevic chose not to demand a retrial. Mr May has been replaced by another British judge, Lord Bonomy. Mr Milosevic wants to call 1,631 witnesses in his defence, including Tony Blair and Bill Clinton. Even if the genocide charge falls, he faces the likelihood of life imprisonment.

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Slovakia

The not-so-bad man wins

Apr 22nd 2004
From The Economist print edition

An upset winner of Slovakia's presidency

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PERHAPS chastened by the mess they made in a first round of voting for a new president on April 3rd, most Slovaks stayed away from the second round on April 17th. The run-off pitted Vladimir Meciar, a ham-fisted ex-prime minister whose authoritarian style set Slovakia back half a decade in the 1990s, against Ivan Gasparovic, who was then Mr Meciar's right-hand man but later fell out with him. In the event, Mr Gasparovic unexpectedly won, with 60% of the votes cast, on a turnout of just 43.5%. His victory came not so much because he campaigned brilliantly, but more because Mr Meciar lost his cool in a televised debate between the rounds, reminding voters what a boorish old bully he was.

The best thing to be said for Mr Gasparovic is that he is scarcely known outside Slovakia, making him less of a diplomatic embarrassment. The presidency is largely ceremonial, but the return of Mr Meciar would still have perturbed NATO and the European Union, which had refused even to consider Slovakia for membership while he was prime minister. Slovakia is joining both organisations this year.

But for domestic political calculations, Slovakia's fragile centre-right coalition government might quietly have preferred a Meciar victory, once its own candidate, Eduard Kukan, had lost in the first round. A grudging respect seems to have grown up between Mr Meciar and his successor as prime minister, Mikulas Dzurinda, despite bitter political differences. Mr Gasparovic is an unknown quantity, the more so since he was helped to victory by Smer, a populist left-wing movement that has overtaken Mr Meciar's HZDS as the most popular party in the country.

The rise of Smer is worrying for the future of Slovakia's reforms, and doubly so when seen as part of a trend towards populist parties in other parts of central Europe. These include Samoobrona, the potato-throwing farmers' movement that leads in Poland's opinion polls. The next test for this awkward squad will be June's elections to the European Parliament, which may find its chamber disturbed by many raucous new voices.

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Italian politics

Bossi's boots

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Its leader gravely ill, the Northern League faces an uncertain future

AP

In happier days

THE Northern League, the third-biggest party in Silvio Berlusconi's coalition government, is in denial. Six weeks after its leader, Umberto Bossi, suffered heart failure, his lieutenants act as if he were getting over the flu. Roberto Castelli, the justice minister, said this week that Mr Bossi would head his party's list in June's European elections. On paper, maybe.

Mr Bossi's family (ie, his wife, Manuela Marrone, co-founder of the Northern League and highly political herself) has persuaded the hospital to impose a news black-out. Only one bulletin has been issued. But hospital sources paint a dire picture. The leader, famed for his booming voice, communicates through a writing tablet. A man of legendary stamina has difficulty moving his left arm and leg. He got out of bed for the first time only this week. Remedial therapy? “Not even in weeks”, says one source. And it is unclear if he has suffered brain damage.

In his absence, the Northern League has done little to give the lie to an opposition politician's taunt that it is “a crew, without a captain, capable of sinking the ship”. The fiction that Mr Bossi could roar back tomorrow has stifled discussion of an interim leader. Two years ago, Mr Bossi called Giancarlo Giorgetti, the 37-year-old secretary of the Lombard League, the original core of the party, his “dauphin”. But any contest could turn into a wrangle between two more senior figures representing opposite wings of a movement rooted in regional concerns, but tinged with populism and an unpleasant distaste for outsiders, whether asylum-seekers or southern Italians. Roberto Maroni, the welfare minister, represents the moderates. Roberto Calderoli, who runs the party machine, is the extreme: he wants dialect exams for immigrants and recently called for the expulsion from Europe of 1,000 Muslims a day until hostages in Iraq were released.

A test looms. More than two-thirds of the local elections being held at the same time as the European ones in June will be in Lombardy, the area round Milan. By dodging a possibly damaging power stuggle, the League risks seeming aimless. Some believe it is doomed anyway. “Without Bossi, the League cannot survive”, says Fabio Cavalera, a veteran League-watcher at the *Corriere della Sera* newspaper.

Mr Bossi's party won less than 4% of the vote in the 2001 election (compared with 10% five years earlier), yet he skilfully engineered a disproportionate representation in government. The League is the third pillar of Silvio Berlusconi's coalition, only slightly less influential than the prime minister's own Forza Italia party and the far-right National Alliance. His disappearance, followed perhaps by his party's, would remove a thorn from the prime minister's side. The threats of withdrawal from the government that Mr Bossi has used to win his way have done more than anything to give the Berlusconi government a reputation for instability. Moreover, if Mr Bossi's party faded away, its voters would not. Surveys suggest that most would switch to Forza Italia.

Soon after Mr Bossi was stricken, Mr Berlusconi joined party faithful at an abbey in Lombardy to pray for his recovery. But the prime minister's prayers may not have been quite as fervent as others'.

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The German-Polish border

A tale of two cities

Apr 22nd 2004 | GUBEN AND GUBIN
From The Economist print edition

Getting back together is hard to do, especially at the German-Polish border

IF BERLIN was the focal point of German unification, Guben and Gubin are at the heart both of European Union enlargement and of German-Polish rapprochement. Almost nowhere else do Germans and Poles live so close to each other as in these twin cities on the River Neisse; almost nowhere else are leaders trying so hard to grow together. Yet though strong forces draw the cities together, much still drives them apart.

Guben and Gubin were once one city, known for its hats and its orchards. But in 1945 the allies settled on the Oder-Neisse line as the new western border of Poland, slicing through Guben. All Germans left the eastern part of the city, to be replaced by Poles, often refugees from eastern regions that became part of the Soviet Union. Although East Germany and Poland were Soviet satellites, the border remained closed, save for a few years in the 1970s. This explains why, even today, Guben and Gubin seem worlds apart. Guben, like most small German cities, boasts a centre that is tidy, deserted and dull. Gubin's centre is livelier, but still marked by wartime bombing.

The two city halls could hardly be more different. It is hard to miss the office of Guben's deputy mayor, Fred Mahro, despite the Kafkaesque corridors in this former hat factory. On the walls are charts of election results and holiday planners. Finding the office of Mr Mahro's Polish counterpart, Zenon Turowski, in a former manor house, takes some doing. Above his desk hangs nothing more than a Polish flag.

Over the past decade the two cities have done much to bridge differences. The results include a common sewage-treatment plant in Gubin, and a school in Guben where classes are taught in both German and Polish. Last October, the two councils decided to co-ordinate decision-making through an “inter-municipal working group”. But the members of the group, headed by Mr Mahro and Mr Turowski, have their work cut out. There are plans to reconnect the two city centres by moving Guben's station and developing an island in the Neisse. The group is thinking of pooling municipal services such as water and waste disposal, and even setting up a joint holding company.

Might Guben and Gubin become one again? They clearly need to co-operate, for they face similar challenges. Both have lost their economic base: Guben its chemical-fibre plant, Gubin its garrison. Unemployment is high: 26% on the German side, 34% on the Polish one. Because of this, people are moving away. Guben has lost more than a third of its population over the past decade. With 22,000 residents, it is no longer much bigger than Gubin. Both cities also struggle to balance their budgets.

Yet the two also have reasons to compete, for both investors and jobs. Here Guben has the edge. Thanks to public money, it has an industrial zone with state-of-the-art infrastructure. To one Italian shoemaker, this is reason enough for settling on the German side. But the firm wants to hire a quarter of its 80-strong workforce in Gubin, which has a tradition of shoemaking and plenty of cheap, skilled labour.

Personal contacts between the two cities are limited. Most people cross the Neisse only to shop; just a few visit friends and relatives. A third of Gubin residents speak some German, but only a tenth of those in Guben know any Polish. The Poles seem keener on unifying than the Germans, according to a study by

Topos, a research firm. Some 84% of Gubin's population wants closer co-operation; 71% favour a merger. In Guben, the numbers are only 52% and 44% respectively. That may be why Gottfried Hain, long a driver of more co-operation, was not re-elected as Guben's mayor. Germans between the ages of 35 and 55 object most. They feel threatened by competition from Polish workers. That is understandable given salaries that are, on average, four times those across the river.

Unsurprisingly, people in both cities have wildly different expectations of EU enlargement. Almost half those in Gubin think it will boost the local economy. But about the same share in Guben worry that it will a have a negative impact.

Add in legal and institutional barriers (Germany is a federal state, Poland a centralised one, something that almost killed the sewage plant), and the road to a common future for the two cities looks bumpy. Yet if Guben and Gubin do not tackle problems together, they risk becoming economically still more marginal, according to one scenario developed by local leaders. And here is a possible lesson for EU enlargement: it could easily turn into a disappointment, especially near borders, if politicians fail to persuade voters that their future lies together.

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Charlemagne

Those other referendums

Apr 22nd 2004
From The Economist print edition

The many hurdles that lie in the way of ratifying the constitution

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NO SOONER had Tony Blair announced that Britain is to have a referendum on the proposed European Union constitution than the Brussels air was thick with accusations of betrayal. The public line is that this is a decision for Britain alone, the will of the people must be respected, etc. Privately, however, senior EU people are spitting. Their panic is understandable. At least in theory, it takes just one of the soon-to-be-25 EU members to refuse to ratify the constitution and the whole thing becomes null and void—hardly a cheering thought for negotiators struggling to tie up the final details by mid-June.

And yet not all partisans of the constitution see consulting the people as an abomination. There is a principled, pro-European group pressing for simultaneous referendums across Europe. Their hope is that this would not only definitively legitimise the document. It might also create that most elusive of things: a genuine pan-European political debate.

It is a nice idea. But reality is likely to be a lot messier. Only four countries are absolutely certain to have referendums: Denmark, Ireland, the Netherlands and now Britain. Another four seem almost certain to: the Czech Republic, Luxembourg, Portugal and Spain. Poland seems likely to join them, and France may yet follow; others are still considering the matter. Yet a pan-European debate is unlikely. The votes will take place at different times, and different aspects of the long and complex constitutional text will prove controversial in different countries.

The Dutch referendum campaign is likely to spend an unusual amount of time on the “stability and growth pact” that sets fiscal rules for members of the euro. The Dutch government was outraged when France and Germany persuaded other euro members to set aside the pact because it was proving inconvenient. The Dutch have been campaigning ever since to get tougher provisions on budget deficits written into the constitution, but with little success. That makes it easier to portray the EU as a club in which bigger members break the rules. More generally, the Dutch are fed up that, in net terms, they pay more per head into the EU budget than does any other country. A Dutch rejection of the constitution is a distinct possibility. And it would be a heavy blow, because the Netherlands is one of the six founder members of the European project and has never had hang-ups about “surrendering sovereignty” to Brussels.

Where the Dutch debate will concentrate on the euro, Irish “No” campaigners plan to focus on other issues such as defence, taxation and criminal law. They will highlight provisions for a “common defence policy” and a mutual-defence guarantee, both of which seem to imperil Irish neutrality. They will point to hints that corporate taxes might in future be set by majority vote. And they will raise hell about provisions to harmonise aspects of European criminal law. But the Irish government thinks it can get most objectionable provisions out of the text in the remaining negotiations.

The British and Danish referendums will have their own flavour, with opponents pressing charges that a “European superstate” is under construction. Jens-Peter Bonde, a prominent Danish Eurosceptic, argues that the constitution lays the legal basis for a European state, by formally asserting the supremacy of European over national law for the first time. British Eurosceptics will make the same argument, and also highlight other areas where the constitution could be portrayed as usurping the functions of the nation-state: for example, its assertion that “member states shall actively and unreservedly support the Union's common foreign and security policy”. In both Britain and Denmark, the “Yes” campaign will respond that articles about legal supremacy and foreign policy are mere codifications of existing practice—indeed, the foreign-policy one simply repeats the 1992 Maastricht treaty, signed by a British Conservative

government.

Whereas the Irish are quietly confident about winning a referendum, the Poles are quietly hysterical about losing one. Until recently the Polish government was fighting like fury against proposals to get rid of the disproportionately large voting weights that current rules give to Poland and Spain. Under enormous pressure from France and Germany, the Poles are now prepared to give way. But even Polish pro-Europeans are pessimistic about the chances of persuading the electorate to accept a diminution in Polish power, combined with more integration. Spain too has had to make painful concessions about voting weights. But the mood there is different, following the election of a Socialist government determined to reassert Spain's European credentials. So a Spanish rejection seems unlikely.

A slow-bicycle race

If the French follow the lead of perfidious Albion and hold a vote, their referendum campaign could be the oddest of the lot. Anxiety that France and the French language are losing ground as the EU expands would form the back-drop to a campaign in which the constitution may be attacked from the far-right and the far-left, as well as by some Gaullists and socialists. The right would stress the loss of national sovereignty and influence within the EU, and would also chuck in concern about possible Turkish membership. The left would argue that the constitution institutionalises an Anglo-Saxon neo-liberal order.

The fact that France could vote against the constitution may yet persuade Jacques Chirac to renege on his previous half-promise to hold a referendum, despite Mr Blair's decision. For those countries that have made the fateful choice, however, the question of timing looms large. The governments that are most confident of victory—Ireland, Portugal and Spain—are likeliest to go first. Those that most fear defeat—Denmark, Britain and perhaps Poland and France—cower at the back, hoping that some other country takes the odium of being the first to say no. But there is a snag. Not everybody can vote last.

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The BBC

Reining in Auntie

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The new media regulator thinks the BBC tried too hard to be popular

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BRITISH television, according to the people who make it, is the best in the world. Vital to its superiority, they argue, is up to £4 billion ($7 billion) of subsidy lavished on it every year. The money is supposed to create something called “public-service broadcasting”, meaning higher quality stuff than the market, left to itself, would provide.

That subsidy has increased sharply under Labour, and so has the scrutiny it has come under. This week Ofcom, Britain's new media regulator, published a report into what taxpayers are getting in return for their money. Its conclusion is that broadcasters are not properly fulfilling their obligation to provide public-service broadcasting. The BBC in particular, says Ofcom, has dumbed down and needs to lift its standards.

Although ITV, Channel 4 and Channel 5 also receive public money, the BBC is by far the biggest supplier of public-service broadcasting thanks to its licence fee. Last year it got £2.7 billion. But its future is uncertain. Before its current charter runs out in 2006, its existence, role and method of funding will be under review.

The BBC's original purpose, according to Lord Reith, its first director-general, was to give people not only what they want, but also what they need: it should educate and inform as well as entertain. But because the BBC is funded by a flat tax on all television households, rich and poor, it also thinks it has to be universally popular to justify its existence. On that count, it did well under the leadership of Greg Dyke, the former director-general, who fell over the David Kelly affair, winning audience share at the expense of both ITV and the quality of its own programmes.

Ofcom has analysed the BBC's dumbing-down. BBC2's spending on arts and drama in peak time has fallen by roughly a fifth since 1998, it says, and BBC1's peak time is increasingly filled with soap operas, while news has been shifted from 9pm to 10pm. The number of new programmes in peak time on BBC1 and BBC2 has declined. As one example of its rival's commercialism, ITV likes to cite the occasion when BBC1 scheduled an extra episode of “Holby City” (a hospital soap) on a Sunday night to steal viewers away from its modern-day production of “Othello”.

With charter renewal on its way, the BBC is showing signs of remembering its public-service remit. But Ofcom's report, which will feed into the government's charter-renewal process, will make worrying reading for the corporation's executives in other ways too.

Increasingly, the government and Ofcom want to justify spending public money on broadcasting using economic theory as well as old-fashioned arguments about improving minds. Views on the future of the BBC and of public-service broadcasting now fall into two camps. One says that most of what the BBC does would be provided by the market if the country dared to cut back the BBC, and that the remainder could be paid for by a public subsidy far lower than what the BBC gets now. The other view, common in the industry, is that broadcasting is too important to be left to the market, which by itself would produce inferior programming.

For the moment, Ofcom is sitting on the fence, arguing that there are two important rationales for public-service broadcasting: one is filling in gaps in the market, and the other is wider social benefits. David Currie, Ofcom's chairman, says that a lot of television in unsubsidised America is “tat and rubbish”. There is comfort for the BBC in his views; but with the proliferation of channels in the digital age, it is getting

harder to sustain the argument that the BBC provides a variety of programming that the market does not.

Ofcom will have more to say later on in the year, when it will become clearer what it intends for the BBC. David Elstein, a former head of Channel 5 who produced a thoughtful report for the Tories on the Corporation, reckons that the regulator is heading towards a narrow definition of public-service broadcasting as a means of correcting market failure. This could result in a reduced role for the BBC.

But even if public-service broadcasting must be limited to the areas where the market fails, the government can find a way to justify keeping plenty of it if it wants to. A narrow definition might limit itself to the odd obscure arts show or ethnic minority programme; a wide one could include, for instance, willingness to tackle social issues such as race or domestic abuse. The first would mean a high-quality channel with a tiny audience (such as BBC4, an excellent digital channel which few watch); the second could include gritty soaps such as “EastEnders”.

Yet the market-failure argument also calls into question the scope of the BBC's activities. The BBC has long trodden on the toes of the commercial sector not only in broadcast television, but also in magazines. In recent years, it has not only expanded its magazine business but also moved into other areas—educational publishing and 24-hour news, for instance—where the private sector is struggling to build businesses, and feels crowded out by the BBC. One particular complaint is that the BBC uses its licence-fee-funded terrestrial channels to promote its commercial activities. “There is a strong case for a BBC with a broad role,” says Ofcom, “but activities should be reviewed against core purposes and characteristics.” That is a threat, in bureaucratese.

But it is the politicians, not the bureaucrats, who will decide the BBC's fate in 2006. Will they try to rein in the BBC? While the government has no interest in seeing its power grow—indeed, its perceived hostility towards the war in Iraq infuriated Downing Street—the BBC is popular, perhaps because it is one of the few remaining manifestations of British culture. What's more, anyone who takes on the people's telly risks being accused of a politically motivated attack. Tangling with Auntie always means trouble.

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DNA fingerprinting

The sins of the fathers

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Criminals in the family? You may now be under scrutiny

CRAIG HARMAN was drunk when, in May 2003, he killed Michael Little by throwing a brick from a motorway overpass. He had neither motive nor connection to the victim, meaning that, under normal circumstances, his crime would have been almost impossible to solve. Unfortunately for Mr Harman, he left traces of blood on the brick; even more unluckily, he was related to someone who had once been arrested, and whose DNA was therefore held on a database. On April 19th, he became the first person to be convicted following an investigation into someone else's genetic "fingerprint".

The technique that led police to their man is a novel but straightforward one. Scientists at the Forensic Intelligence Bureau coded the DNA recovered from the crime scene as a 20-number sequence, and fed it into a computer. A few hours later, they had a list of people who shared 11 or more genetic markers with the brick-thrower (while two people chosen at random are likely to share six or seven markers, 11 or more suggests a blood relative.)

Two basic assumptions helped to narrow the list further, according to Jonathan Whitaker, a senior scientist at the bureau. "First, offenders tend to commit crimes on their own doorstep, and, second, family members don't move far away from one another." Having counted out faraway and genetically dissimilar people, investigators were left with a local man whose DNA shared 16 markers with the blood sample. He was Mr Harman's brother.

Britain leads the way in this sort of genetic sleuthing, mostly because the national database is large enough to make "low stringency" searches, which locate partial matches, worthwhile. For years, the police have scraped tissue from the mouths of people charged with offences that carry a prison term, whether or not the case goes to trial. This month, they began taking swabs from people merely arrested for such crimes, with all the resulting genetic fingerprints being held indefinitely. Such zeal explains why, since 1995, the National DNA Database has collected 2.3m genetic profiles, representing 5% of the adult population (and 9% of all men). This is more than any other country in the world: in America, by contrast, the FBI's database holds profiles for less than 1% of adults.

So far, DNA profiling has achieved good results without attracting much controversy. It has made it easier to clear up crimes like domestic burglary, where detection rates stand at 48% when DNA is recovered (compared with 14% when it is not). Tight control over laboratories has allowed Britain to avoid the sort of scandals that have cast doubt on DNA testing in America.

And, until this week, most people reckoned they couldn't be traced through their genetic profile unless they had already had a brush with the law themselves. The technique used in the Harman case changes all that. A method that has, for the past two decades, been used almost entirely to identify or rule out known individuals can now be used to find people through their black-sheep relations.

At £5,000 ($9,000) a throw, family searches are still too expensive for police forces to request them in any cases other than the most serious. But the technology is likely to become cheaper and more sophisticated, which will produce problems as well as benefits. Since the arrest of one person makes it easier to trace members of their family, and since police investigations produce yet more DNA for the database, there is a danger that the criminal justice system will be seen as picking on a few clans. One solution would be to collect everyone's data, says Chris Asplen, a legal adviser on DNA. "That would be a much more egalitarian system than one where you shop for people's relatives."

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Theft

Shed pounds with a PA

Apr 22nd 2004
From The Economist print edition

How Goldman Sachs executives found themselves a few million light

AP

Joyti lightened their load

THE notion that top executives have to be paid huge sums to incentivise them received a blow during the trial of Joyti De-Laurey, a secretary at Goldman Sachs. Mrs De-Laurey was convicted of stealing some £4.5m ($8m) over a period of 14 months from two people she worked for. Neither noticed for a year. One of them, Edward Scott Mead, a former partner at the firm who had made £50m when the company went public in 1999, realised something was amiss when he discovered, one night after dinner, that there wasn't enough money in one of his bank accounts to make a £1m donation to Harvard. Ron Beller, another Goldman Sachs employee and husband of the other victim, Jennifer Moses, said, “I did think my account seemed one or two million dollars light.”

But if the case has left Goldman Sachs clients wondering why they pay the company such vast fees when its executives are oblivious to the size of their earnings, it will have done the company's recruitment prospects no harm. Britons have been treated to a wealth of delicious detail about the trough of cash available to Goldman Sachs executives. Those who have left off salivating at, for instance, Mr Beller's £86,000 bill for personal travel in one year, are presumably filling in their job applications.

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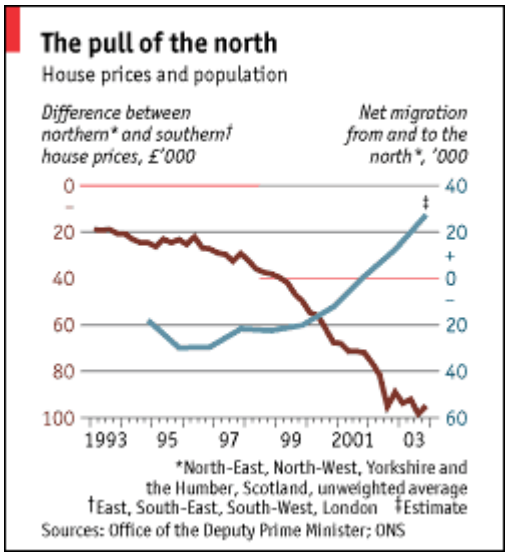
Migration

Why is Britain moving north?

Apr 22nd 2004 | NEWCASTLE-UPON-TYNE
From The Economist print edition

The usual migration pattern has been reversed: Scotland and the north of England are gaining people



BETTER jobs and brighter lights mean that, for years, thousands have headed southwards from Scotland and northern England. The concentration of people and economic growth in the south has led the government to announce plans to shift thousands of bureaucrats out to the provinces. But recent figures show that the usual pattern has already reversed, and people are moving north (see chart).

There is much debate as to why this is happening. One explanation is the disparity in house prices between the north and the south. The slowdown in the northern exodus began when southern houses became more than twice as expensive as northern homes. The bigger the gap, the harder it is for northerners to move south. At the same time, the price differential makes moving north more attractive to southerners, which is partly why northern house prices have recently risen faster than southern prices. And these days, people can respond more easily to house prices: e-mail enables them to cash in their London houses, move out of the city and keep working.

But others think that it is not just to do with house prices. Michael Parkinson, urban affairs professor at Liverpool John Moores University, says that the quality of life has improved in northern cities. On indicators ranging from more jobs to less crime and better schooling, they are performing better than they used to. In some cases, such as earnings growth and airport traffic, growth in Liverpool and Manchester is outstripping that in London. The benefits of years of inner-city regeneration, along with events such as the Commonwealth Games in Manchester and Liverpool's winning of the European Capital of Culture 2008 title, mean that these days northern cities are seen as more attractive places to live.

Demos, a voguish think-tank, maintains that some bits of the north—Newcastle and Gateshead, in particular—are enjoying a cultural “brain gain”. Economic revival in such cities, it maintains, means that more of the students who go there to study stay after graduation. Newcastle University, for example, which draws around four-fifths of its students from outside the north-east, says that the proportion of its British graduates staying in the region has risen from 39% to 45% over the past four years.

Most northern cities' populations fell sharply in the 1980s and 1990s. Mr Parkinson points out that they have, in most cases, stabilised, and some are now growing again. “Given a fair wind globally and the government doing a bit more to shift things from south to north, there's enough already happening economically and politically to suggest northern cities can sustain their improvement over the next five to seven years,” he reckons.

But the economic foundations of the north's population expansion are fragile, as Andrew Burrell, an economist at Experian, a business consultancy, points out. During the 1990s, private-sector growth, particularly in financial services in London, drew people southwards. That stopped in 2001. Over the past three years, expanding public services have created jobs everywhere. Moving out of London is particularly attractive to public-sector workers, whose salaries tend to be lower than those in the private sector. But government spending is not going to go on growing at the rate it has been, and there are signs that employment in financial services is beginning to expand again.

The big question is whether this migration reversal is a blip or a trend. If, as seems likely, house prices are the main cause, then it is probably the former. Philip Rees, professor of population geography at Leeds University, says that during the last southern house-price bubble in the late 1980s, there was net immigration to the north. Then the bubble burst and the exodus resumed.

Whether or not the house-price bubble bursts this time around, the north-south house-price differential is already shrinking. If the north goes on drawing people in, that means a genuine northern renaissance is under way.

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WH Smith

Bid blood and private equity

Apr 22nd 2004
From The Economist print edition

The ancient newsagent may fall to a bid. And then who's next?

WH SMITH'S share price, 260p at the end of last week, closed at just under 350p on April 19th, after one-sixth of the shares had changed hands in a day, on news that a private-equity firm had in mind a bid of 375p. It wasn't alone. Woolworths, Somerfield and Marks & Spencer, three other troubled retailers, were all up about 5%, a fat gain on a day when the market overall barely budged. The speculators smelled blood.

In recent years' stockmarket gloom, the old-fashioned takeover battle among quoted companies eager to expand has given way to a still older fashion, the swoop of the outright predator ready to grab some enfeebled prey and sell it on at a profit. Often, the predator is a private-equity group, and the profit, after a year or two, very juicy: Permira, the firm now eyeing WH Smith, is said to have quadrupled its investment in Homebase, a do-it-yourself retailer that it bought from Sainsbury's in 2000 and sold to GUS within two years.

Life has been grim of late for WH Smith. It put in a new chief executive in November, but still had a dire Christmas. Six-month figures to end-February, out this week, showed a pre-tax loss of £72m, after hefty write-downs, against an already modest £54m profit a year ago.

One reason for WH Smith's vulnerability was illustrated sharply two days earlier when Tesco published its results. Its sales were up 14% to £500m a week in Britain alone, and a year's operating profit there of about £1.5 billion, near half WH Smith's entire turnover. The giant marches on: food, clothes, household appliances, newspapers, books, CDs, medicines, petrol, finance, even telephone service: nothing seems beyond its reach. It is also now moving into high-street convenience stores. Asda, now owned by Wal-Mart, also has moved out from its original food business into high-street retailers' specialities. And then there's the internet, which is eating into sales of books and CDs.

So what would Permira do with WH Smith? Break-up is a possibility. WH Smith is a diversified bunch of assets. Over half its £3 billion turnover comes from selling books, newspapers, CDs, stationery and more in Britain's high streets, hotels and airports; and though it has quit that line in the United States, it still sells £170m in Asia and Australia. Another third of turnover comes from distributing papers to its own shops and to rivals. Still further upstream, it publishes £150m of books (including, since 2002, those of John Murray, once Byron's publisher). Trade distribution, publishing and the Asia-Pacific retailing, which is already up for sale, could fetch £450m, leaving Permira only about £500m down for the British retailing and shops.

But that is just where the trouble lies, and new managers, however talented, would face the same problems as the old ones. The two men fronting Permira's bid are both ex-WH Smith executives, and say firmly they see it as a going business. But there is a reason why retailing is a favourite field for private-equity firms: nifty financial footwork can extract cash from high-street shops. Freehold (though WH Smith has under £25m of these), they can be sold, and then maybe leased back. Even held on short leases (£80m-odd), some are worth more to a retailer in a different line than to their current operator. Smart handling of the property portfolio is another way for a predator to recoup its cash.

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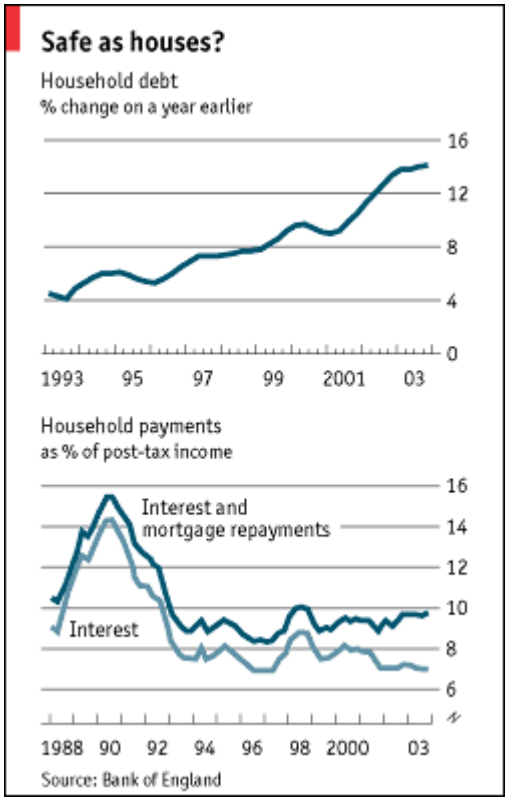
Household finances

Debt threat

Apr 22nd 2004
From The Economist print edition

Borrow in haste, repent at leisure



SO SUCCESSFUL is the economy, said Gordon Brown in a speech to businessmen on April 21st, that other countries are now examining "the new British model" of macro-economic management. The chancellor's claim came in the wake of figures showing a decline in annual inflation to 1.1% and a fall in unemployment to a low of 4.8% of the labour force. The "misery" index, which combines the inflation and unemployment rates, has become a misnomer for Britain's sunlit economy.

But a dark cloud threatens a return to the old British model of boom and bust. Household debt has been rising at 14% a year and is now worth 135% of post-tax income. This autumn it will top a trillion pounds. Sensing a political opportunity, Oliver Letwin, the Conservative shadow chancellor, has set up a commission chaired by Lord Griffiths, an economist, to examine the problem.

In a speech launching the inquiry, Mr Letwin highlighted the social impact of debt. Individual insolvencies were at their highest since the early 1990s. He drew attention to the fact that the debt burden—measured in relation to income—was heaviest among poor households.

Mr Letwin's social worries appear well-founded. Citizens' Advice Bureaux report that over a million people have asked them for help about debt in the last year, an increase of over 40% since 1997. According to a survey by the Bank of England, a third of those who owe money on unsecured borrowing (such as credit cards and personal loans) say the debt is a burden; a tenth say that it is a heavy burden.

But does debt, including the much bigger share secured on property, pose a wider threat to the economy? Quizzed about this recently by MPs, Mr Brown sought to soothe fears. He said that households now had to set aside 7% of their disposable income to pay interest on their debts—well below the average in the past 15 years. Another reason to remain calm is that households have assets as well as debt. So although mortgage debt is £800 billion, it is secured on houses worth nearly £3 trillion thanks to the boom in house prices.

But worries persist. Interest payments may be low in relation to income, but that mainly reflects lower inflation. The sting in the tail for borrowers is that they can no longer count on rapid increases in prices to erode the real burden of their debt. A broader measure of mortgage costs which includes regular repayments of the original loan stands at almost 10% of income. The increase in interest rates expected by the markets will push this debt-servicing burden up to the level of the early 1990s, according to Sir Andrew Large, deputy governor of the Bank of England in charge of financial stability.

As for debt in relation to assets, the value of property can fall as well as rise. On April 21st, the International Monetary Fund gave warning that Britain was vulnerable to "an abrupt correction in the housing market". The IMF has estimated that house prices are a third over-valued. Removing that excess would slash the value of housing assets by £700 billion.

A recent pick-up in house-price inflation magnifies the potential for a damaging crash. Despite low inflation, the Bank of England is still expected to raise interest rates in May. Higher borrowing costs may have left consumers unscathed to date but they will eventually bite. With so much debt and with house prices so over-valued, there will be a painful reckoning.

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Dropping out

Child bribe

Apr 22nd 2004
From The Economist print edition

Will paying reluctant students to study work?

Get article background

COMING last in beauty pageants is never nice, particularly if you care a great deal about your looks. This is the position of secondary education in Britain.

The government made education a priority when it took power in 1997, but students continue to drop out once they have endured the bare minimum of compulsory schooling. According to the OECD, less than 70% of 25-to-34-year-olds have completed upper secondary education in Britain. That compares badly with rich countries like America and France, as well as less-developed eastern Europe, where the proportion is 80% or more.

In order to try to boost those numbers, the government will pay some 16-year-olds to stay on from September. Children whose parents earn less than £30,000 will be eligible for a means-tested sum of between £10 ($18) and £30 during term, paid directly into their accounts every week. There are also five £100 bonuses for improvements in the two years after compulsory education stops and before higher education starts. The Department for Education and Skills (DFES) estimates that around 353,000 16-year-olds will be eligible for an Education Maintenance Allowance (EMA), which will cost about £500m.

Bribing children to stay at school seems odd, but it is not unique. Australia has been doing it since 1988. Over that period, it has overtaken Britain in the 16-18-year-olds-in-school stakes, hence the imitation.

Pilot schemes run by colleges in poor areas did show that the EMAs worked as an incentive, increasing the rate of staying on by about 6%. If that was replicated nationally, it would act like a pair of high heels that would make Britain internationally presentable on the graphs showing dropout rates. The increase was greatest among children from the poorest families, who were around 10% more likely to stay on when offered EMAs. Neither the Institute for Fiscal Studies, which analysed the results, nor the participating colleges, know how many of the extra students passed their exams at the end, though, so the academic benefits are not clear.

There will be a huge dead-weight cost built in, since in many cases the government will be paying students to stay who would have done so anyway. Ivan Lewis, the under-secretary at the DFES responsible for the programme, says the department has not worked out what this cost is, but says that setting up the scheme so that only those who might have dropped out are eligible is impossible.

The pilot scheme was not glitch-free, however. Barbara Weilding of Salford College, one of the participants in the trial, said that there were problems with parents spending cash intended for the children. The paperwork for the scheme was also time-consuming. On the upside, Salford found that the power to take the carrot away helped improve behaviour.

Coming soon after the government gave universities power to charge students more for courses, paying younger ones looks paradoxical. Mr Lewis says he “doesn't believe in any way this is giving out mixed messages”. Many educational theorists agree, arguing that as children advance through their education, learning changes from a public good into a more private one. Whether this thinking will persuade students used to being paid to study at college that paying to go to university is a good idea is less clear.

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Bagehot

Plenty of risk, not much reward

Apr 22nd 2004
From The Economist print edition

Tony Blair wants to settle Britain's place in Europe once and for all. He can't

Get article background

FOR all the enjoyable mockery of Tony Blair's sudden discovery of the reverse gear he unwisely claimed not to have, it seems perverse to portray the decision to hold a referendum on the European constitution as a failure of prime ministerial nerve. If anything, it is further evidence that Mr Blair has become an adrenaline junkie. As if the drama of Iraq and the succession of knife-edge Commons votes needed to keep his reform agenda alive were insufficiently thrilling, Mr Blair has now persuaded himself that he must resolve, “once and for all”, Britain's place in Europe.

Given his hitherto dismissive rejection of calls for a referendum, Mr Blair's about-turn is astounding. He has consistently maintained that the draft constitution is of less moment than either the Single European Act of 1986 or the Maastricht treaty of 1992, both of which were ratified by Parliament alone. Thanks to Britain's “red lines”—its insistence on maintaining the power of veto over foreign and defence policy, taxation, social security and the European Union's budget—the constitution was, he claimed, nothing more than a conflation of existing treaty provisions combined with some sensible measures for making the enlarged union work more efficiently.

As Mr Blair made clear when telling MPs on April 20th that he now supported a referendum, this is what he still thinks. What he conspicuously failed to do, however, in the course of one of his worst parliamentary performances, was to explain what had so dramatically changed his mind.

The short answer appears to be the foreign secretary, Jack Straw. Mr Straw had come to believe that the refusal to countenance a referendum was turning into a serious problem. Although most Labour MPs continued to trot out the prime ministerial line about why there was no need for one, Mr Straw believed it was sapping morale in both the party and the cabinet. As one adviser put it: “They were very uncomfortable; they actually felt ashamed of the arguments they were using.”

As long as Spain and Poland were holding out over voting rights, the prospect of EU member countries reaching agreement on the constitution remained remote and there was no urgent reason to press for a change in policy. However, the election of the new Spanish government last month altered that calculation. Even though there could well be further delays, there was now a real prospect of everything being wrapped up this June. Mr Straw further realised that, given the febrile mood of Labour MPs and, more particularly, the growing bolshiness of the House of Lords, the bill to ratify the treaty was likely anyway to be amended with a clause providing for a referendum.

Mr Straw argued that, rather than be bounced into conceding a referendum, the government should seize the initiative, and thus deprive the Tories of their best tune on Europe ahead of the European Parliament elections in June. As parliamentary scrutiny and Britain's presidency of the union in the latter half of next year would make it difficult to hold a referendum much before spring 2006, promising one would help the government to keep the focus on domestic issues in the run-up to the general election. And it would allow an accommodation with Rupert Murdoch that would keep his newspapers in Labour's camp.

Both Mr Blair and the chancellor, Gordon Brown, were initially doubtful—Mr Blair because he lives in terror of Britain's predominantly Europhobic press, Mr Brown because he believes the government has handled the constitution badly. It has, he believes, been insufficiently tough in negotiation and disingenuous over the treaty's importance.

As Easter approached, Mr Straw finally won them over. Mr Brown agreed that nothing should be allowed

to distract attention from his economic achievements. For his part, Mr Blair was persuaded that if he really wanted to dispel what he sees as the fog of myth and distortion which in Britain shrouds all discussion of Europe, this might be his only opportunity as prime minister. A referendum on the constitution would be a proxy for the indefinitely postponed showdown over the euro.

With the referendum issue thus parked, the prime minister is itching to expose the consequences of the "no" vote the Tories will be campaigning for. Michael Howard's superficially attractive vision of a multi-speed Europe may yet come to pass as the union of 25 evolves. But the Conservative leader will have to explain what effect a retreat to Europe's periphery might have on Britain's status and influence in the world.

The wisdom of Enoch

It is still a desperate gamble that Mr Blair has embarked on. A YouGov poll in the *Sun* indicated just how desperate. Only 16% said they would vote in favour of the constitution, while 53% would vote against. The only scrap of comfort for the prime minister came from responses to another question: by 60% to 18%, people thought it was not true that "Britain will still be able to keep control of its taxes, defence, criminal justice and foreign policy if a new European constitution does come into force." If Mr Blair can convince voters that his red lines really are inviolable, he might be in with a chance. But that depends on how much they trust Mr Blair—these days, not much.

Mr Blair retains an almost mystic faith in his powers of persuasion, touchingly undimmed by recent experience and the cynicism he now provokes. He is determined to end what he calls Britain's historic ambivalence towards Europe. He is looking, in effect, for some kind of closure before he quits the scene.

It's a poignant illustration of Enoch Powell's observation that all political careers end in failure. Not, in this instance, because it is impossible for Mr Blair to win a vote on the constitution, but because no referendum—a mere snapshot of momentary opinion—can deliver what Mr Blair yearns for.

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Royal Dutch/Shell

Sick and tired about lying

Apr 22nd 2004
From The Economist print edition

The crisis at Shell has become much more serious

"I AM becoming sick and tired about lying." Those are not words shareholders want to hear from a senior executive. They are certainly not words anybody ever expected from an heir-apparent at Royal Dutch/Shell, one of the world's largest—and until recently, one of its most admired—oil companies.

And yet, as a new report revealed this week, those words of exasperation did indeed come from a senior Shell executive. Walter van de Vijver, until recently the firm's head of exploration and production (E&P), wrote them in an angry e-mail to Sir Philip Watts, then the firm's chairman, in November 2003—fuming that he was tired of covering up for shortfalls in the firm's reserves that resulted from "far too aggressive/optimistic bookings". Alas, the over-zealous booker was none other than Sir Philip, who preceded him as head of E&P.

The overbooking finally caught up with both men when, in January, Shell was forced to reclassify a whopping fifth of its "proved" reserves. When preliminary investigations pointed the finger at the two men, both were forced out.

This week, Shell's board unveiled part of the final results of those investigations. An analysis of reserves, done by Ryder Scott, an audit firm, explained what happened to the numbers, and an investigation of documents and processes by Davis, Polk & Wardwell, a New York law firm, explained how and when it happened.

The big unanswered question, however, is why it happened. Was it just Shell's "technocratic hubris", as one manager called it, leading it to ignore the increasingly strict rules of America's Securities and Exchange Commission (SEC) about booking reserves, without pausing to think about the consequences of, in effect, lying? Or had Sir Philip been deliberately inflating the figures, taking full advantage of Shell's own, loose, guidelines to conceal disappointing exploration results and so book himself into the top job?

The report into how the phoney numbers emerged paints a picture of deception and backbiting at the top—and, despite ongoing board efforts to exonerate the new management, contains plenty to encourage shareholder lawsuits and, maybe, criminal prosecutions, not least in America, where jail may await. More senior Shell people may yet have to quit.

Empty Shell

In the mid-1990s, it is now clear, Shell lost its way, finding it ever harder to replace the oil and gas reserves that it was pumping out of the ground. In 1997-2001, when Sir Philip was head of E&P, the firm inflated the reserves that it reported to the SEC as “proved”. The SEC defines proved as reserves that the company has firm plans to get to market quickly. Many oil executives dismiss this measure as a misleading guide to the value of a firm. But, nonetheless, it is a legal requirement for oil companies listed in America.

This week's Ryder Scott report “de-books” a further 1-2% of proved reserves, less than some analysts had feared. Shell's numbers may now, at last, be believable. Oddly, auditors do not routinely scrutinise reserve figures, despite their use in valuing oil companies. Shell now has only 14.5 billion barrels of proved oil and gas, which represents about ten years' worth of current production. BP has 18.3 billion barrels, enough for over 14 years; Exxon Mobil has more than 21 billion, which could keep it going for almost that long. Shell has been falling behind its peers for years in reserve replacement—and massaging the numbers to conceal the fact.

The report by the lawyers cited memos, e-mails and details of private meetings to show how Mr Van de Vijver and Sir Philip fought over the handling of the firm's shaky reserves position. The lurid details (for example, talk of a “script” and of keeping investors “fooled”) make it clear that both men knew that reserves were inflated—although Mr Van de Vijver alone seemed to want the truth to be made clear.

One possible interpretation of all this has Sir Philip doing his best to cover up his past over-bookings, while Mr Van de Vijver struggled in vain to become a fully-fledged whistle-blower. But one senior director describes instead a prolonged drift at Shell as top management slowly came to realise that their numbers had strayed far from the SEC rules. Says one insider, neither Sir Philip nor Mr Van de Vijver really understood how “serious, serious” the situation was becoming. Directors also say, bitterly, that Shell's auditors failed to point out that the firm's reserving guidelines did not comply with SEC rules.

The report suggests that Judy Boynton, the (now-ex) chief financial officer (CFO), and Jeroen van der Veer, Sir Philip's replacement as chairman, were informed about the problems—as was the committee of managing directors. Mr Van der Veer says that he did not “appreciate the magnitude and severity of the situation”.

Robert Roseman of Spector, Roseman & Kodroff, one of several American law firms now bringing class-action suits against Shell, is delighted: “This makes our case a whole lot easier, because these e-mails show that people high up in Shell clearly knew what was going on and hid it from investors.”

The two boards that control the group (Royal Dutch and Shell) tried this week to spin the reports as the definitive cleansing of its sins. The two board chairmen exonerated all members of the current management and boards, claiming that “none of them bore a material responsibility for the difficulties.” Judy Boynton, the CFO, had to step aside, but her integrity was “unimpeachable”; she will remain as an adviser. The chairmen insisted: “We have complete and unreserved confidence in the leadership of Jeroen van der Veer.”

There is already reason to consider such faith unjustified—and not just because various American authorities are investigating. The big worry goes back to that basic question left unanswered by the reports—why did things go so wrong at Shell?

Dealing with what ails the firm will not be easy. The measures floated this week may help. But they seem unlikely to be enough to change the culture of the place. The awkward bi-national structure, with two weak boards and a committee of managing directors, leads to an inward-looking bureaucracy that breeds arrogance. A more straightforward reporting structure with one board, a chairman and a chief executive might do better, although in the Netherlands, where Royal Dutch/Shell stills enjoys huge respect as a national champion, there has been little appetite for change—and Dutch shareholders have the voting power to block it.

Some British directors have been advocating a single board and a dual listing for years. Perhaps the new reports will wear down Dutch resistance. However, to transform the culture would probably require an accomplished outsider in the top job, willing to question everything and push through changes. But the boards seem unlikely to opt for that.

At least the crisis has had no significant impact on Shell's cashflow. Indeed, it may demonstrate

impressive underlying strength on April 29th, when its first-quarter results are likely to show a “clean” profit of some $3 billion. Hence Mr Van der Veer's grand claim: “Despite the difficulties of recent months, Shell is a sound and profitable group. We are making the changes to our reserves practices to ensure that that remains the case.” We shall see.

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Biodefence

Drug problem

Apr 22nd 2004 | NEW YORK
From The Economist print edition

A worrying failure to engage the drug industry in the war on terror

IF TERRORISTS had placed smallpox, rather than explosives, on the Madrid trains that blew up last month, tens of thousands, maybe millions, could have died instead of the 190 people who did. Few threats worry terrorism experts more than smallpox—not least in Washington DC, where the government has been trying to fortify its stocks of smallpox vaccine. But Acambis, its prime smallpox-vaccine contractor, has hit problems. It has just announced the halting of a pivotal third-phase clinical trial on a smallpox vaccine it has been developing, because some patients in the trial started to suffer from heart disease. This could delay development, and stockpile fortification, by years.

The Acambis project was the cornerstone of the Bush administration's biodefence efforts. It is now an example of the problems plaguing those efforts. Despite America being home to the world's largest, best-equipped, most innovative drug makers, building biodefence products is proving extraordinarily difficult.

Developing new drugs, though it can be hugely profitable, is hugely risky. Even if a drug performs well in clinical trials, which often involve fewer than 1,000 patients, it can later turn out to have nasty side-effects as a larger number of patients use it. Far more new drugs fail than succeed. No drug firm would dream of putting all its development bets on one product, and no investor with sense would put money into just one drug firm. Yet such obvious points seem lost on the Bush administration which has, in effect, bet the nation's safety on Acambis and its vaccine. While most of the biodefence grants and contracts it has handed out average less than $10m, Acambis controls a $771m contract to provide smallpox vaccine.

Even before the September 11th 2001 terrorist attacks, an independent panel of experts submitted a report to Congress noting that the military programme for developing vaccines and other countermeasures against bioweapons is “insufficient and will fail.” Last month, a study by the Federation of American Scientists concluded that there are weaknesses in “almost every aspect of US biopreparedness and response.” Nowhere is this more true than in America's stockpiles of biodefence diagnostic tests and medicines.

Big drug companies are looking the other way. And even America's leading biotech firms, which are best placed to develop such products, have shown little interest. Most publicly-traded biotechs are deterred by the tepid reaction on Wall Street to the few firms developing biodefences, such as Avant Immunotherapeutics, Cepheid and Acambis. Few firms are attracted by the meagre development grants doled out by the Pentagon, which largely oversees America's biodefence effort, nor by the accompanying paperwork and bureaucracy. The American Venture Capital Association, in a recent report, “Government Market Enigma Causes Industry to Stick with What They Know”, concluded that biodefence “is not an open market; it is ‘politically charged with shifting priorities'; and the appropriations cycles lack predictability.”

America's bioterrorism experts reckon that close to 100 new diagnostics, vaccines and treatments are needed urgently. By most estimates, building these biodefences will take at least 5-10 years and $50 billion. And if America's highly innovative drug industry does not rise to the challenge, such efforts that are underway elsewhere will not fill the gap.

The Bush administration's main programme, Project BioShield, was announced in January 2003, but is stalled in Congress and largely ignored by the drug industry. A fraction of BioShield's proposed $6 billion budget has been advanced to help pay for biodefence research and development. Most of this money has gone to government and university laboratories, which have little experience of developing products. Besides, even $6 billion is nowhere near enough.

In December 2001, a bill known as Lieberman-Hatch was tabled that would have bypassed the Pentagon procurement system, introducing a sweeping new performance-based, market-oriented system of incentives designed to tempt the drug industry to take biodefence seriously. The bill would have introduced patent protections and restrictions on product liability, plus industry-standard profit margins for products that successfully make the journey from research to stockpile. Alas, the bill remains stalled—not least because of the feeling in Congress that it would be widely seen as a give-away to an already pampered drug industry. Yet without something like Lieberman-Hatch and its real-world market incentives, biodefence medicines and test kits simply will not be made. Let's hope they are never needed.

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About sponsorship

Russian oil

Freezing to death

Apr 22nd 2004 | MOSCOW
From The Economist print edition

More trouble for Yukos

Get article background

AFP

Britain's richest Roman

NOT since the 1998 economic crash has a Russian firm been so savagely insulted. This week, after a court had frozen all of Yukos's assets (except for its oil), in response to a claim by Russia's government for $3.5 billion in back taxes, Standard & Poor's, a rating agency, downgraded Yukos's credit-worthiness by five notches to CCC, just above “default” grade. Then, on April 22nd, tax inspectors raided the Yukos head office.

This looks to be the latest of many attempts to break the grip of Mikhail Khodorkovsky, Yukos's ex-chief executive, who has sat in jail for six months awaiting trial. His arrest for tax fraud and embezzlement, it is widely agreed, was a punishment for his attempts to block government plans for the oil sector, among them raising taxes and closing loopholes. Since then courts have also frozen some 40% of the Yukos shares that are thought to belong to Mr Khodorkovsky and his close partners, and some more shares that Yukos issued as part payment for Sibneft, another oil firm. After his arrest, the two firms agreed, in principle, to split up again, but have failed to agree the terms; last week Simon Kukes, Yukos's current boss, even said that Sibneft's original shareholders—not least Roman Abramovich, who owns Chelsea Football Club in London and was recently listed as Britain's richest man—have not made any offer to buy back their shares.

Some think that is where the latest court order comes in. With its assets frozen, Yukos probably cannot pay $3.5 billion all at once, says Ronald Smith at Renaissance Capital, a Moscow investment bank. If it sells its Sibneft shares back—though they would first have to be unfrozen—it can. That would leave Yukos alone to face whatever fate the government has in store for it.

But the court order could be, instead, merely another way to put pressure on Mr Khodorkovsky, and to send the clear message to other businessmen that meddling in government affairs will cost them dear. There is said to be an informal list of 15 or so magnates, including Mr Abramovich, who might face similarly unpleasant treatment if they do not show particular obedience. This week, at the Russian Economic Forum in London, Alexei Kudrin, Russia's finance minister, suggested that if those magnates pay their taxes and play by the rules, there might yet be an amnesty for those who prospered so greatly in the rigged privatisations of the 1990s. But at the moment, he said pointedly, “that is not the most popular idea in Russia.”

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Business in China

D'Long caught short

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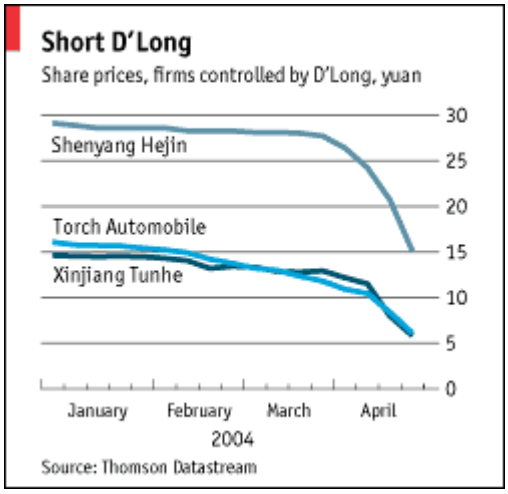
From The Economist print edition

One of China's new model companies runs into old-style trouble

IT IS usually badly managed state-owned enterprises in China that run into difficulties, while the country's dynamic private firms forge ahead. Usually, but not exclusively. Over the past week, local investors have become concerned about the financial health of D'Long Strategic Investments, one of China's biggest, most high-profile private firms—and one of the few to have successfully ventured abroad.

Three domestically-listed firms in which D'Long holds controlling stakes recently issued statements noting that D'Long has been using the shares it owns in them as collateral for loans. This has fuelled concerns that the group has overreached itself. In recent days, the share price of the three firms—Torch Automobile, which makes car parts, Shenyang Hejin, an electrical tool maker, and Xinjiang Tunhe Investment, one of the world's biggest ketchup producers—have plunged. Each has now fallen by half or more since the start of the year (see chart).



On April 16th, D'Long claimed that the announcements had sprung from a technical change in its banking agreements and that the shares are pledged against existing loans, not new ones. However, it also gave warning on its website that efforts by the government in Beijing to rein in China's overheating economy were making it harder to borrow from (state) banks and that this would force "necessary changes" to its development strategy. On April 21st, its chairman, Tang Wanli, admitted to the state-owned *China Securities Journal* that the speculation about D'Long's health—and the falling share prices—was leading to real financial problems, as worried banks cut off cash and demand hard collateral on loans. Mr Tang said that one affiliate had to use its workers' own money to finish a construction project.

Mr Tang emphatically denied what he called a "longstanding view" of D'Long, that it has been using its vast web of stakes in financial institutions including banks, brokerages, insurance firms, investment trusts and leasing firms, to funnel money into its own businesses. It is this that Hu Shuli, the managing editor of China's hard-hitting *Caijing* business magazine, whose latest issue features a seven-page investigation of D'Long, says is at the heart of concerns about the company.

Examples of poorly managed, even fraudulent, Chinese firms that have no concept of corporate governance are legion. The case of D'Long, however, is significant for several reasons. First, its size. With an annual turnover of $4 billion and 15,000 employees it is one of the country's largest private firms. Founded in the 1980s as a photo-processing business by Mr Tang and his three brothers, it now dominates regional flour markets, makes noodles and 85% of China's tomato paste, is a big cement producer and is also in mining, tourism, textiles and farming. Crucially, given suspicions about its cash flows, half its revenues come from financial services.

D'Long has also expanded overseas—still only a dream for most Chinese firms—by snapping up western brands. In 2000, it bought Murray, an American lawnmower and bicycle maker, once owned by Britain's Tomkins, with $400m in financing provided by GE Capital. It also bought some of the assets of bankrupt German aircraft group Dornier Fairchild. It bid for Grundig, a German television and home-appliance maker, but in January lost to a Turkish/British consortium.

Moreover, D'Long, with controlling stakes in five listed companies, minority holdings in several more (as well as investments in hundreds of unlisted private firms), touches 35% of China's stockmarket, according to the group's president, Benny Li. Certainly, its discomfiture has been a blow to investor confidence, report local brokers in Shanghai. And this bad news comes just as China's domestic A-share market is having its first good run after prolonged underperformance.

But the real significance is that D'Long has been held up by its admirers as the prototype of a modern, Chinese-style conglomerate: one that thanks to a spread of businesses and management talent could overcome the distortions and red tape common in developing markets. As such, it appeared to be in pole position to buy up more state assets cheaply as the government continues to sell them off.

That may still happen if the current storm blows over. Mr Li told *The Economist* last year that D'Long was “constantly” being investigated, but that due to its size, its extensive holdings on the stockmarket and its large and regular tax payments, his group was “too big too fail”. But in a country where the government remains ambivalent towards private enterprise, preferring to bet on state-fostered “national champions”, that may prove to have been an empty boast.

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About sponsorship

The porn industry

Debbie doesn't do Dallas

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From The Economist print edition

Lights, cameras but no action

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AP

It's rude to point

THE wages of sin, or a rare breakdown of self-regulation? California's flourishing porn-movie industry is suddenly in crisis thanks to the announcement on April 13th that a “veteran performer”, Darren James, had tested positive for HIV. Some 13 women who had, ahem, acted with Mr James since his last negative test were immediately “quarantined”—their names published in the hope that no one will work with them for 60 days. Also quarantined are a “second generation” of 40 or so actors, male and female, who had had sex with that “first generation”. In the words of Mary Carey (pictured), a porn star who last year ran to be governor of California, “It's very scary. This is a kind of wake-up call for everybody.”

The industry, based in the San Fernando valley, just outside Los Angeles, is keen to promote a responsible image. HIV-testing at least once a month is, for all practical purposes, obligatory: actors will not perform with someone who cannot produce a clean test result. Darren James had his clean bill of health—but there is a two-week period between infection and detection and it seems that Mr James had earlier been performing on a film set in Brazil, where testing is lax and many performers are HIV-positive. As soon as Mr James tested positive, virtually all production houses signed on to a 60-day moratorium on filming—though some said they would keep things ticking over by making “girl-on-girl” movies. Porn star Jenna Jameson and her producer husband announced they would set up an “assistance fund” to help out actors suddenly deprived of their usual livelihood.

Alas for the producers, the Los Angeles County Department of Health Services is unimpressed. On April 19th, it said that male actors must in future wear condoms—and that California's regulations on health and safety at work are enough to require condoms on film sets, just like they do hard-hats on building sites.

The producers argue that the actors are independent contractors, and thus not covered by the regulations. What they really mean is that films with condoms sell less well than films without, hence only two of some 200 production houses in southern California are “condom only”, and less than one-fifth of the industry's 1,200 performers regularly use condoms. That could change. This week Adam Glasser, a producer known in the industry as Seymore Butts, said he was instituting a condom-only policy for all his future films. This is risky. When an HIV-scare last hit the industry, in 1998 before testing became mandatory, some producers did start a “condom only” policy—and suffered for it.

In other words, the commercial question is whether state regulation of films with such imaginative titles as “Travel Sluts 2” and “Pussy Pageant” will drive the producers to follow so many of their Hollywood cousins into making their movies outside expensive, litigious America. Will the porn business—now making some 4,000 films a year, mostly in California, worth anywhere between $3 billion-13 billion in annual sales—be the next of America's industries to be “outsourced”?

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The newspaper industry

Yesterday's papers

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From The Economist print edition

America's newspaper-publishing industry succumbs to more scandal

SCANDAL-HIT businessmen wounded by the attacks of outraged newspaper editors may have felt a keen *Schadenfreude* this week. On April 20th, the editor of *USA Today*, Karen Jurgensen, resigned abruptly following a scandal involving one of her star foreign correspondents, Jack Kelley. Last year, Howell Raines, then editor of the *New York Times*, eventually fell on his sword in the wake of a similar scandal involving his own star reporter, Jayson Blair. Now that the editors of two of America's three leading national newspapers (the third is the *Wall Street Journal*) have succumbed to scandals, the publishing industry will no doubt be worrying about who may be next.

An investigation by *USA Today*'s own reporters alleges acts of fabrication and fraud that would have made the most wicked bubble-era boss blush. In one story, Mr Kelley describes how a Cuban woman drowned in a storm while attempting to flee to America. *USA Today*'s reporters claim to have established that there was no storm that day, that the woman did not flee Cuba and that she is living in America, having immigrated legally a year ago. In another acclaimed piece, Mr Kelley describes his own eye-witness account of a suicide bombing in Jerusalem. Under a headline that reads “Unbelievable timing, incredible account”, *USA Today*'s reporters recount how Mr Kelley claimed to witness the decapitation of three customers of a pizza restaurant that was hit by the blast. “In a first draft that Kelley submitted for publication,” write the reporters, “he wrote that some of their heads rolled ‘with their eyes still blinking'.” Israeli police contacted by *USA Today* reported no decapitations as a result of the bomb.

In a first-hand account of his troubles at the *Times*, published recently in the *Atlantic Monthly*, Mr Raines appears to blame his fall mainly on a backlash against his efforts to change the culture of “smug complacency” at the *Times* that Mr Raines says pervaded its reporting efforts. According to his analysis, the traditional *Times* franchise had been suffering steady erosion as a result of heightened media competition and the encroachment of the internet. His answer was to raise the “competitive metabolism” of the paper by throwing large numbers of journalists behind what Mr Raines judged to be important stories. Former colleagues call this Mr Raines's “flood the zone” strategy.

The weakness of such an approach, which Mr Raines fails to acknowledge, is that such aggressive competition may erode editorial judgment—and along with it the basic checks and balances that newspapers are supposed to have in place to ensure at least factual accuracy. Although *USA Today*'s own investigation into its editorial leadership is not yet complete, the staff reporters working on the Kelley story appear to suggest similar weaknesses in their paper's strategy. The newspaper's editors, it seems, were too eager to believe the “unbelievable” reports filed by its newspaper-selling, Pulitzer-prize finalist, star foreign correspondent.

Ultimately, it is the customer—the reader—who holds newspapers to account. That explains the extraordinary efforts of both newspapers to investigate and deal with their problems publicly as they fight to protect their brands. Yet the problems of growing competition and the internet identified by Mr Raines remain. For the daily newspaper industry, there are no easy answers.

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Bad service

A complaint is a gift

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And Americans get better service than Brits because they know how to give it

AUSTRALIANS call the British “whingeing Poms” because they grumble so much. But a new study suggests that Brits should whinge more, not less.

A team led by Chris Voss of the London Business School found that service quality in Britain is typically worse than in America. One reason, the research suggests, is that British customers complain less about bad service than hard-to-please Americans do.

The failure to grouse is pervasive. Hunter Hansen, an American who runs the Marriott hotel in London's Grosvenor Square, notes that a British guest would make a fuss only about a significant problem—and even then, would do so in a roundabout way. Americans are critical of even small mistakes.

The result, Mr Voss finds, is that Brits suffer. But so do companies in Britain's service industries: they do not receive so much unsolicited feedback, and thus lose a chance to improve service quality. Indeed, they may spend more than they need to do on service-quality improvements, because they do not get direct help from customers.

Management gurus know more about how companies respond to complaints than about why the British are phlegmatic. In America, well-run companies have “service recovery” strategies. Staff at the Marriott group are drilled in the LEARN routine—Listen, Empathise, Apologise, React, Notify—with the final step ensuring that the complaint is fed back into the system. The Ritz-Carlton hotel chain, another with a good reputation for handling complaints from customers, trains its staff not to say a mere “sorry” but “please accept my apology” and gives them a budget to reimburse cross guests.

When Brits finally screw up their courage to grouse, they get results. Mr Voss told his doctor that he would appreciate speedier feedback after a consultation. “The next time round, I got it,” he says, in mild surprise.

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Low-cost airlines

Crowded skies

Apr 22nd 2004
From The Economist print edition

Why are so many airlines starting up?

Get article background

THIS week Michael O'Leary, who runs Ryanair, Europe's most aggressive budget airline, predicted that the fares war that is driving down his—and his main rivals'—yields would continue. He forecasts that many of the fast-growing flock of new low-cost carriers will eventually go bust. The war is no longer just between flag-carrier network airlines on one side and budget airlines on the other.

Most aviation start-ups nowadays are low-cost carriers. Since the terrorist attacks of September 11th 2001, which—along with economic slowdown, the Iraq war and SARS—prompted a deep slump in the industry, no fewer than 60 new airlines have got off the ground. Even Lufthansa, which long dismissed the threat from budget airlines, has just raised its stake in one, Germanwings, to roughly half, so it can better fight Ryanair's and easyJet's German expansion.

Paradoxically, it is the troubles of the industry that have driven the proliferation of new airlines—a striking burst of creative destruction. As the traditional network carriers shrank to cope with the crisis, they left more scope for low-cost competitors to expand and for niche airlines to enter markets abandoned by the carriers.

The crisis also meant that there were lots of aircraft, pilots and engineers available at bargain prices. Keith McMullan of Aviation Economics, a London-based consultancy that has worked on several start-ups, reckons that the barriers to entry in the airline business have been beaten down. It now costs as little as $10m to launch a low-cost carrier, he reckons. Narrow-body Boeings and Airbuses, the sort favoured by budget airlines, are available at roughly half what they cost in the late 1990s. There is a glut of good second-hand models, because the established low-cost carriers have been buying new planes from airplane manufacturers at deeply discounted prices instead of fishing in the used-plane market.

Another factor behind the rush of start-ups is the availability of off-the-shelf software that runs the internet-based bookings systems crucial to a low-cost carrier. The software also handles the demand-management system that jacks up prices as a flight fills up. A budget carrier will typically multiply some fares tenfold in the run-up to a holiday such as Easter.

Perhaps the most basic push behind the flock of new little airlines is the availability of a simple and proven business model—though exactly how many carriers can profitably use it may soon become clearer. Most of the new carriers are low-cost airlines based on the model developed in America by Southwest Airlines and copied first in Europe by Ryanair and easyJet. Asia—where the leader is AsianAir—and eastern Europe are the latest places to get the budget airline bug, with half a dozen start-ups each in recent months.

However there have been only three start-ups in America since September 11th, according to a study by Aviation Economics. Two of these, Ted and Song, belong to big network carriers, United Airlines and Delta Air Lines respectively. But Britain's Sir Richard Branson, after years of deliberation, is now poised to make a splash with a Virgin offshoot in America. He has hired Fred Reid, who was recently passed over for the top job at Delta, to run it, and is in the process of deciding where to put its base. Already, many American cities are eagerly wooing him with special offers, such as low landing fees and help with marketing costs.

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Face value

The Big Mac succession

Apr 22nd 2004
From The Economist print edition

MAXPPP

Jim Cantalupo's sudden death brought out the best in McDonald's board

Get article background

AT HIS first annual meeting as chief executive, Jim Cantalupo faced an angry shareholder displaying photos of a filthy McDonald's toilet and demanding action. “We are going to take care of it,” he pledged. And he did. His strategy of ending the rapid expansion of the world's biggest fast-food company and refocusing it on providing better meals in cleaner restaurants with improved service was starting to produce encouraging results. Then, on April 19th, he suddenly died. The death of a leader at such a critical time can ruin a company. But, thanks not least to Mr Cantalupo, it will probably not ruin McDonald's.

Mr Cantalupo was a McDonald's veteran. He joined the company in 1974, as an accountant in its headquarters near Chicago. As head of international operations, he presided over much of the globalisation of the Big Mac: McDonald's now has more than 30,000 restaurants in 119 countries. Although promoted to president, he was passed over for the top job when Jack Greenberg was appointed chief executive in 1998.

Then McDonald's began to stumble badly. Service levels came in for increasing criticism, sales began to fall and the company suffered its first quarterly loss. It also became embroiled in the debate about obesity and the role of fast food. McDonald's was even sued by some parents for making their children fat. (Although this failed, a future lawsuit may yet succeed.) Mr Greenberg put a recovery plan into action and vowed to stay on to execute it, only to be forced out by worried investors. The board turned to Mr Cantalupo, who came out of retirement to take over as chairman and chief executive in January 2003.

Mr Cantalupo, who was 60, died of a suspected heart attack at a huge convention in Orlando, Florida, for more than 12,000 employees, suppliers, owners and operators of McDonald's restaurants worldwide. It was the sort of big meet-the-troops event that the affable Mr Cantalupo enjoyed.

Those members of the board already in Florida quickly assembled and others joined by phone. Within six hours, Charlie Bell, a 43-year-old Australian who had been appointed chief operating officer by Mr Cantalupo and had been working closely with him, was made chief executive. Andrew McKenna, 74, the board's presiding director and also the boss of Schwarz Paper, which supplies McDonald's with lots of packaging materials, was appointed non-executive chairman.

The speech that Mr Cantalupo was due to give to welcome the delegates was later given by Mr Bell, who joined the McDonald's empire when, aged 15, he got a part-time job in an outlet in a suburb of Sydney. So he knows how to flip a burger. The delegates were clearly saddened, but they gave Mr Bell, the first non-American to lead the company, a resounding reception. Mr Cantalupo would have approved.

So did Jeffrey Sonnenfeld, head of the Chief Executive Leadership Institute at Yale University. “It was a board operating at its finest,” says Mr Sonnenfeld, author of “The Hero's Farewell”, a book about the contentious job of selecting a new boss.

Concerning Mr Cantalupo, the McDonald's board has twice acted impressively, he says. First, it acted decisively in reversing course and turning to Mr Cantalupo when things went wrong. Second, it acted swiftly to execute a succession plan that Mr Cantalupo himself had put into place, even though he was expected to remain in the job for several more years. Mr Bell had been widely acknowledged as Mr Cantalupo's heir apparent.

Succession planning can be fraught with difficulty, and is all too often neglected. Vodafone had no succession strategy in place when, in December 2002, Sir Christopher Gent, its chief executive, said he would leave. A search for a replacement led to Arun Sarin, a non-executive director, being given the job. Now Vodafone operates a succession-planning process in every country where it has a business. But more formal procedures, though on balance superior, can cause difficulties, especially if an officially anointed heir starts to get restless (ie, Prince Charles syndrome). And it takes a trusting, well-disciplined board to stick to a succession plan, as the General Electric board did when Jack Welch groomed three potential contenders for his job.

Burger and Coke

A sudden death can be the toughest kind of succession to deal with. Some bosses are said to leave a sealed envelope holding the name of a preferred successor in the event of a fatality. Yet the succession at McDonald's, forced on it by tragic circumstances, contrasts sharply with that now under way at Coca-Cola. Ever since Roberto Goizueta, Coke's pioneering boss, died of lung cancer in 1997, the firm has been beset by troubles. Douglas Ivester was appointed quickly to replace Mr Goizueta, but two years later was forced to step down. In February, his successor, Douglas Daft, suddenly announced that he would retire by the end of this year. Coke is said to want James Kilts, the boss of Gillette, for the top job—but he may not want it. Publicly looking outside its ranks for a leader is interpreted by some analysts as evidence of management weakness within.

McDonald's could not be accused of that, although Mr Bell still has to prove his worth. New menus, featuring smaller portions and such healthier things as salads and bottled water, are reviving the company's image. But at the same time the company cannot afford to drive away its many fans of burgers and fries. Simply getting them to come back more often could do wonders for McDonald's profits. There are valuable lessons to be learnt from successful markets, such as Australia and France—both places where Mr Bell has worked. But there remains a long way to go, and things could yet become extremely difficult. Even planning well ahead and having a chosen successor ready and waiting, though better than not doing so, is no guarantee that the successor will actually be a success.

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Business innovation

Don't laugh at gilded butterflies

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Rather than chasing wonder new products, big companies should focus on making lots of small improvements

THE Gillette company's website flashes out a message to the e-visitor: “Innovation is Gillette”, it claims. There are few big companies that would not like to make a similar claim; for they think innovation is a bit like Botox—inject it in the right corporate places and improvements are bound to follow. But too many companies want one massive injection, one huge blockbuster, to last them for the foreseeable future. Unfortunately, successful innovation is rarely like that.

The latest manifestation of Gillette's innovative skill will appear in stores in North America next month. The global leader in men's “grooming products” is rolling out a successor to its popular three-bladed Mach3 range. It will not, as comedians had long anticipated, be a four-bladed version (Schick-Wilkinson Sword reached that landmark first, in September 2003, and Gillette has taken it to court for its pains). Rather, it will be the world's first vibrating “wet shave” blade. The battery-powered M3Power is designed to bounce around on your skin to give (yes, you guessed it) “a smoother, more comfortable shave”.

For a company that claims to embody innovation, this is less than earth-shattering. On the innovation scale it falls closer to Brooks Brothers' new stain-proof tie than to the video-cassette recorder or the digital camera—especially since there is a suspicion that Gillette may be keener to create synergy between its razor and its batteries division (it owns the Duracell brand) than it is to usher in a genuinely new male-grooming experience.

But the launch is symptomatic of an important business trend: blockbuster new products are harder and harder to come by, and big companies can do much better if they focus on making lots of small things better. Adrian Slywotzky of Mercer Management Consulting says that, “in most industries, truly differentiating new-product breakthroughs are becoming increasingly rare.” He claims, for example, that there has not been a single new dyestuff invented since 1956.

Even in relatively zippy businesses like pharmaceuticals, genuinely new products are fewer and further between. Spending on pharmaceutical R&D has doubled over the past decade, but the number of new drugs approved each year by America's Food and Drug Administration (the industry's key regulatory hurdle) has halved. Drug companies still live in the hope of finding a big winner that will keep their shareholders happy for a long time. But this focus means that many unglamorous, but potentially interesting, compounds may be bottled up in their laboratories.

The road to invention

Big companies have a big problem with innovation. This was most vividly described by Clayton Christensen, a Harvard Business School professor, in his book, “The Innovator's Dilemma” (Harvard Business School Press, 1997). Few conversations about innovation take place without reference to this influential work.

The Oxford English Dictionary defines innovation as “making changes to something established”. Invention, by contrast, is the act of “coming upon or finding: discovery”. Whereas inventors stumble across or make new things, “innovators try to change the status quo,” says Bhaskar Chakravorti of the Monitor Group, another consulting firm, “which is why markets resist them.” Innovations frequently disrupt the way that companies do things (and may have been doing them for years).

It is not just markets that resist innovation. Michael Hammer, co-author of another important business book (“Re-engineering the Corporation”, HarperCollins) quotes the example of a PC-maker that set out to imitate Dell's famous “Build-to-Order” system of computer assembly. The company found that its attempts were frustrated not just by its head of manufacturing (who feared it would lead to most of his demesne, including his job, being outsourced), but also by the head of marketing, who did not want to upset his existing retail outlets. So the innovative proposal got nowhere. Dell continued to dominate the business.

Mr Christensen described how “disruptive innovation”—simpler, cheaper and more convenient products that seriously upset the status quo—can herald the rapid downfall of well-established and successful businesses. This, he argues, is because most organisations are designed to grow through “sustaining innovations”—the sort, like Gillette's vibrating razor, that do no more than improve on existing products for existing markets.

When they are hit by a disruptive innovation—as IBM was by the invention of the personal computer and as numerous national airlines have been by low-cost carriers—they are in danger of being blasted out of their market. This message found a ready audience, coming as it did just as giant businesses from banking to retailing, and from insurance to auction houses, were being told that some as-yet-unformed dotcom was about to knock them off their pedestal.

Innovative lessons

William Baumol, a professor at New York University, argues that big companies have been learning important lessons from the history of innovation. Consider, for example, that in general they have both cut back and re-directed their R&D spending in recent years. Gone are the droves of white-coated scientists surrounded by managers in suits anxiously awaiting the next cry of “eureka”. Microsoft is a rare exception, one of the few big companies still spending big bucks on employing top scientists in the way pioneered by firms such as AT&T (with its Bell Laboratories) and Xerox (with its Palo Alto Research Centre, the legendary PARC).

This will prove to be a wise investment by Microsoft only if its scientists' output can be turned into profitable products or services. AT&T and Xerox, when in their heyday, managed to invent the transistor and the computer mouse (respectively); but they never made a penny out of them. Indeed, says Mr Baumol, the record shows that small companies have dominated the introduction of new inventions and radical innovations—independent inventors come up with most of tomorrow's clever gizmos, often creating their own commercial ventures in the process (see table).

Miracles of the small inventors

Innovations by US small firms in the 20th century

Air conditioning	Hydraulic brake
Assembly line	Integrated circuit
Audio tape recorder	Microprocessor
Biomagnetic imaging	Overnight national delivery
Continuous casting	Personal computer
Defibrillator	Quick-frozen food
Digital X-ray	Safety razor
DNA fingerprinting	Soft contact lens
FM radio	Vacuum tube
Front-end loader	Zipper

Source: US Small Business Administration, Office of Advocacy 1994

But big companies have shifted their efforts. Mr Baumol reckons they have been forced by competition to focus on innovation as part of normal corporate activity. Rather than trying to make money from science, companies have turned R&D into an “internal, bureaucratically driven process”. Innovation by big companies has become a matter of incremental improvements within the processes that constitute daily operations.

In some industries, cutbacks in R&D reflect changes in the way that new products travel down the “invention pipeline”. During the late 1990s, for example, Cisco Systems kept itself at the cutting edge of its fast-moving high-tech business (making internet routers) by buying a long string of creative start-ups financed originally by venture capital. The company's R&D was, as it were, outsourced to California's venture capitalists, who brought together the marketing savvy of a big corporation and the innovative flair of a small one—functions that were famously divorced at AT&T and Xerox.

These days there is less money going into venture capital, and a new method of outsourcing R&D is on the increase. More and more of it is being shifted to cheaper locations “offshore”—in India and Russia, for example. One Indian firm, Wipro, employs 6,500 people in and around Bangalore doing R&D for others—including nine out of ten of the world's top telecom-equipment manufacturers.

Pharmaceutical giants continue to get their hands on new science by buying small innovative firms, particularly in biotech. Toby Stuart, a professor at the Columbia Business School in New York, thinks that this shows another change in the supply chain of invention. He says that many of the biotech firms are merely intermediating between the universities and “Big Pharma”, the distributors and marketers of the fruits of academia's invention. Universities used to license their inventions to these firms direct, but small biotech companies make the process more efficient. They are well networked with the universities, in whose “business parks” they frequently locate their offices. They may not, of themselves, be very innovative.

Companies need to resist the feeling that it is not worth getting out of bed for anything other than a potential blockbuster. Product cycles are getting shorter and shorter across the board because innovations are more rapidly copied by competitors, pushing down margins and transforming today's consumer sensation into tomorrow's commonplace commodity. Firms have to innovate continuously and incrementally these days to lift products out of the slough of commoditisation. After it used innovation to create a commoditised market for fast food, McDonald's struggled before recently managing to reinvigorate its flow of innovations.

Finding a niche

Another factor to take into account is the fragmentation of markets. Once-uniform mass markets are breaking up into countless niches in which everything has to be customised for a small group of consumers. Looking for blockbusters in such a world is a daunting task. Vijay Vishwanath, a marketing specialist with Bain, a consulting firm, says that Gillette's bouncy blade may yet end up as no more than a niche product—fine if it is profitable.

Mr Chakravorti believes that the problem lies with the marketing of new innovations. It has not, he says, caught up with the way that consumers behave today. “Executives need to rethink the way they bring innovations to market.” Too many are still stuck with the strategies used to sell Kodak's first cameras almost 120 years ago, when the product was so revolutionary that the company could forget about competition for at least a decade. Today, no innovation is an island. Each needs to take account of the network of products into which it is launched.

Companies that fail to come up with big new headline-hitting blockbusters should not despair. There are plenty of other, albeit less glamorous, areas where innovation can take place. Management thinkers have identified at least three. Erik Brynjolfsson of the MIT Sloan School of Management, says that the roots of America's productivity surge lie in a “genuine revolution in how American companies are using information technology”. Good companies are using IT “to reinvent their business processes from top to bottom”.

Reinventing, or simply trying to improve, business processes can offer surprising benefits to firms that do it well. The software that runs many business processes has become an important competitive weapon. Some business processes have even been awarded patents. These are controversial and, because they may stifle rather than encourage the spread of new ideas, are probably not in the wider public interest. Yet Amazon obviously views its patent for one-click internet purchasing as valuable, and there are plenty of other examples, particularly in the financial-services industry.

Nevertheless, there is no doubt that, patented or not, what Mr Hammer calls “operational innovation” can add to shareholder value. In an article in the April issue of the *Harvard Business Review*, he asks why so few companies have followed the examples of Dell, Toyota and Wal-Mart, three of the greatest creators of value in recent times. None of them has come up with a string of revolutionary new products. Where

they have been creative is in their business processes.

While superficially mundane, Wal-Mart's pioneering system of “cross-docking”—shifting goods off trucks from suppliers and straight on to trucks heading for the company's stores, without them ever hitting the ground at a distribution centre—has been fundamental to the company's ability to offer lower prices, the platform for its outstanding success. Is it not over the top, though, to glorify such a common-sense change with the title “innovation”? For sure, it does not call for a higher degree in one of the obscurer corners of science. But Wal-Mart did something no competitor had ever dreamed was feasible and that was highly innovative.

Mr Hammer, who was once a professor of computer science at MIT, believes that the best qualification for innovation is a basic training in engineering. Crucially, he says, engineers are taught that design matters; that most things are part of a system in which everything interacts; that their job is to worry about trade-offs; and that they must continually be measuring the robustness of the systems they set up. Such a frame of mind, he believes, fosters innovation. It may be no coincidence that many of the greatest corporate leaders in America, Europe and Japan, past and present, trained first as engineers.

Companies are being encouraged to embrace other forms of innovation too. In a recent issue of the *MIT Sloan Management Review*, Christopher Trimble and Vijay Govindarajan, two academics from Dartmouth College's Tuck School of Business, recommend that they try a little “strategic innovation”. The authors point to examples such as Southwest Airlines, a low-cost American regional carrier, and Tetra Pak, a Swedish company whose packaging products are handled at least once a day by most citizens of the western world. Such companies succeed, they say, “through innovative strategies alone, without much innovation in either the underlying technologies or the products and services sold to customers.”

Tetra Pak's strategic innovation involved moving from the production of packages for its customers to the design of packaging solutions for them. Instead of delivering ready-made containers, the company increasingly provides the machinery for its customers to make their own packages: the fishing rod, not the fish.

But customers can then use only Tetra Pak's own aseptic materials to make their containers. This strips out all sorts of transport and inventory costs from the production process, for both Tetra Pak and its customer. It also makes it very difficult for the customer to switch suppliers.

Southwest's innovative strategies include its bold decision to increase capacity in the immediate aftermath of September 11th 2001, and its carefully timed rolling out this May of competitively priced routes focused on Philadelphia, an important hub for the ailing US Airways, an airline lumbered with an expensive legacy (such as highly paid crews). The low-cost carrier “is coming to kill us,” said US Airways chief executive David Siegel shortly before his recent resignation. And he was not exaggerating.

In his recent book, “How to Grow When Markets Don't” (Warner Books, 2003), Mr Slywotzky and his co-author Richard Wise recommended another form of innovation. “A handful of far-sighted companies”, they claim, have shifted their focus from product innovation to what they call “demand innovation”. They cite examples such as Air Liquide and Johnson Controls, which have earned profits not by meeting existing demand in a new way but “by discovering new forms of demand” and adapting to meet them.

The French company Air Liquide, for example, was a market leader in the supply of industrial gases. But by the early 1990s gas had become a commodity, with only price differentiating one supplier from another. As its operating income plunged, Air Liquide tried to behave like a far-sighted company: it almost doubled its R&D expenditure. However, it reaped few fruits. An ozone-based alternative to the company's environmentally unfriendly bleach for paper and pulp, for example, required customers to undertake prohibitively expensive redesigns of their mills.

The company's saviour came serendipitously in the form of a new system for manufacturing gases at small plants erected on its customers' sites. This brought it into closer contact with its customers, and led it to realise that it could sell them skills it had gained over years—in handling hazardous materials and maximising energy efficiency, for example.

After exclusively selling gas for decades, Air Liquide became a provider of chemical- and gas-management services as well. In 1991, services accounted for 7% of its revenues; today they are close to 30%. And because service margins are higher, they account for an even bigger share of profits. An ozone-based bleach could never have done half so well.

The dilemma solved?

In his latest book, “The Innovator's Solution”, published late last year, Mr Christensen argued that established companies should try to become disruptive innovators themselves. He cites, for example, Charles Schwab, which turned itself from a traditional stockbroker into a leading online broker, and Intel, which reclaimed the low end of the semiconductor market with the launch of its Celeron chip.

There are, says Mr Christensen, things that managers can do to make such innovations more likely to happen within their organisations. For example, projects with potential should be rapidly hived off into independent business units, away from the smothering influence of the status quo. The ultimate outcome of any one disruptive innovation may still be unpredictable; the process from which it emerges is not.

In the end, though, “no single innovation conveys lasting advantage,” says Mr Hammer. In the toys and games business today, up to 40% of all products on the market are less than one year old. Other sectors are only a little less pressured. Innovation and, yes, invention too, have to take place continually and systematically.

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Financial markets

When rates rise

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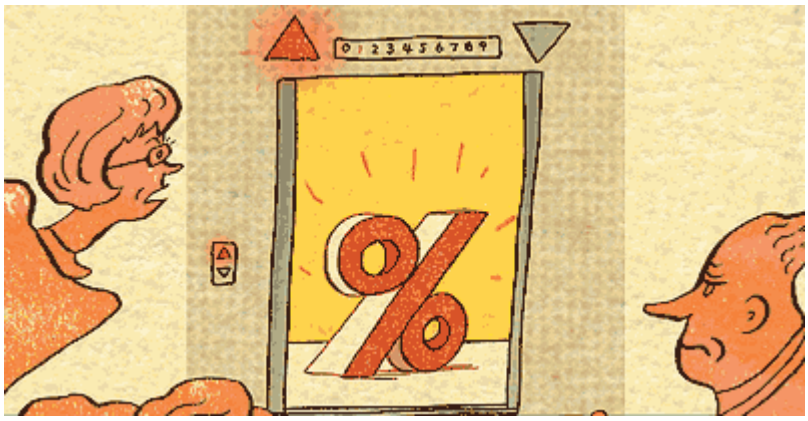
From The Economist print edition



The Federal Reserve is softening the financial markets up for higher interest rates. Will the markets merely dislike them or hate them?

IT IS a truth universally unacknowledged by investors that risk today is so little rewarded. Financial markets, especially the riskiest, have risen strongly in rich and poor countries alike over the past year or so, fuelled by extraordinarily low interest rates in America. But the day when the Federal Reserve raises rates is drawing closer. In two speeches to Congress this week Alan Greenspan, its chairman, said in his usual unflamboyant way that deflation was no longer a risk, that interest rates would have to rise at some point, and that banks were prepared for when they do.

Here's hoping. For it is debatable that financial markets and the banks that deal in them will turn out to be as relaxed as Mr Greenspan about a rise in the Fed funds rate from its current, derisory 1%. Enthusiasm for risky assets is waning in any case.

Even the Treasury market, where the world's risk-free long-term rate is set, is unenthused. Yields have been low partly because it has been enormously profitable for investors to take advantage of the near-record steepness of the yield curve (the difference between short- and long-term rates), and partly because of huge purchases by Asian central banks. But having fallen sharply after February's anaemic jobs report, Treasury yields have soared in recent days as one economic statistic after another has added to the impression that inflation, as well as growth, is picking up. The yield on ten-year Treasuries on April 21st was 4.42%, almost 80 basis points (hundredths of a percentage point) more than it was a month ago.

Most economists think that an appropriate yield on ten-year Treasuries would be 5.5% or so. A rise to anything like that level in the near future depends, among other things, on whether inflation really is picking up and on how swiftly the Fed raises rates to ward it off. It will also depend on whether Asian central banks think it wise to keep their currencies artificially low against the dollar now that domestic inflationary pressures are rising.

Still, as long as growth continues to barrel along, rates probably will rise. What effect will this have on riskier markets? Investment-grade bonds may fare as badly as Treasuries, because most of their return comes from movements in interest rates rather than in the extra yield—known as the credit spread—that investors get for buying a corporate rather than a Treasury bond. They may fare worse, since the credit spread has fallen by more than half in the past year and has room to rise. Yields on junk bonds, especially the real rubbish, probably have further to rise, despite having risen recently.

As for equities, there is an entirely respectable view that since interest rates are rising only because of strong growth, shares will still do well: recovery should be good for profits, which are thought to have grown by almost a fifth in the past quarter. Not surprisingly, many brokers are arguing just that.

This is not being borne out by events, despite generally good company results. Spooked by higher bond yields, the S&P 500 has shuddered recently, and has fallen back to roughly where it was at the beginning of the year. Sectors most exposed to rising rates, such as real-estate investment trusts (down 13% from their high) and, for all Mr Greenspan's soothing words, banks (down 8%), have suffered. In part this may be because stocks are not cheap. NASDAQ, whose prices have long defied reason, has fallen by still more than the S&P.

The argument may anyway be flawed. According to research from Credit Suisse First Boston, stocks underperformed cash globally by 12% when the Fed tightened in 1994, and by 5.4% in the 1984 tightening cycle. CSFB points out that sectors that do badly when bond yields rise now account for a much bigger slice of market capitalisation than in the past. It is, of course, possible, say the bank's strategists, that equities could prosper. “But we tend to think that the risk of a subsequent crash would rise dramatically if that does happen.”

Sinking or swimming?

With the exception of Japan, which seems to be detaching itself and at last to be enjoying a sustainable recovery (see article), most rich-country equity and corporate-bond markets will take their cue from Wall Street. Whether the same is true of emerging markets is a moot point.

Emerging-market equities have had a fine run, helped by inflows (in Asia, record inflows) from rich-country investors, especially Americans. An index of such shares compiled by Morgan Stanley is up by 89% from its low in October 2002—and has risen by 10% this year (see chart). But emerging stockmarkets tend to do less well than their emerged counterparts after risk appetite has peaked.

Emerging-market bonds may do much less well (see article). Historically, these have not been for the faint-hearted: the ups can be thrilling, but the downs are stomach-churning. So well have emerging-market bonds performed in recent months that the spread over Treasuries of the widely watched EMBI+ index of emerging-market bonds is close to a record low. The upside, in other words, is limited.

The downside is much less so. In a report this month, the IMF went out of its way to show that the stellar performance of emerging-market debt was not based on improved fundamentals. “Research suggests that low short-term interest rates have been a key determinant of emerging bond spreads,” it said.

Low rates have arguably been a prime determinant for risky-asset markets just about everywhere. They probably explain why yields on risky junk bonds are so nugatory. Investors have been fleeing rock-bottom interest rates for higher-yielding assets, or simply playing the difference between the two.

Nobody knows how many investors have been tempted to do this, nor how long it will take for rising rates to dull their appetite. But the most exposed are the big hedge funds and global banks that punt with borrowed money. Investment banks have increased the size of their trading positions threefold or more since the autumn of 2002. This is partly because they have devoted more capital to trading. But falling volatility in financial markets means their risk-management models assess the riskiness of these positions to be less. This means that they can have larger positions for the same amount of capital. Even though the Fed is widely expected to raise rates at some point, the incentive to keep generating profits is great—and every bank thinks that it will be clever enough to move first.

The biggest punters, according to a friendly risk manager who crunched the numbers on a comparable basis for *The Economist*, are Citigroup, UBS, Goldman Sachs, Deutsche Bank, J.P. Morgan Chase and CSFB. Some have more capital to cushion them than others. The most thinly upholstered of the big players are Deutsche and Goldman.

If markets move sharply against them, banks and other similarly leveraged investors are forced either to dump positions or to stump up more capital. Almost invariably they choose the former, which can turn a fall in financial markets into a rout. This was what happened in 1998, after Russia defaulted. But Mr Greenspan probably knows that.

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Brazil and the markets

Doubting Lula

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From The Economist print edition

Financial markets lose a little of their confidence in Brazil's president

Get article background

FOR international investors, Brazil's new president, Luiz Inácio Lula da Silva, was one of last year's most pleasant surprises. The burly, bearded former union organiser had looked like the sort of person who would throw fiscal caution to the winds and let creditors suffer the consequences. At one pessimistic moment in 2002, before Mr da Silva's election, the yield on the benchmark Brazilian "C-bond" was 24 percentage points above that on American Treasuries (see chart).

Soon after taking office, Lula (as Mr da Silva is usually known) and his able finance minister, Antônio Palocci, convinced the financial markets that they were, in fact, sober men determined to pay Brazil's debt, reduce its burden on the economy and win the country an investment-grade credit rating. The resulting plunge in yields (ie, rise in the bond price) represented one of the biggest financial bonanzas of 2003. But worries are now creeping in. On April 15th the spread between C-bond and Treasury yields widened by more than half a percentage point; the gap has grown by more than two points since mid-January.

In part, Brazil is suffering from a malady common to high-yielders: the fear that America's Federal Reserve will raise interest rates to squelch inflation, drawing capital away from riskier emerging markets. J.P. Morgan Chase's EMBI+ index of emerging-market bonds fell by 3.3% between mid-January and mid-April. But the Brazilian component, which makes up 22.7% of the index, shed more than 10%. It is not surprising that the highest flyer should fall the furthest, but something else is going on.

The problem is that Lula's economic policies are less popular with Brazilians than they are with bond traders. Upon taking office his economic team raised the government's targeted primary surplus from 3.75% of GDP to 4.25%, in effect choosing to spend more on servicing debt and less on roads, schools and salaries. At the same time the central bank raised interest rates, which were already high, to blunt an inflation spike, the result of a slump in the currency that was in turn caused by the markets' mistrust of Lula. His government won credibility, but the economy shrank in 2003 and his promises of jobs and economic justice began to seem empty.

Can Brazil's orthodox economic policies take the stress? Much depends on how the economy performs between now and municipal elections in October. Most forecasters expect growth of 3-4% in 2004, but that is not as good as it sounds. Exports are booming and sales of big-ticket items like cars have been helped by the 10½-point cut in interest rates since the middle of last year. But this has yet to give much lift to incomes or employment, and the economy has looked shaky in early 2004.

Speculation has been mounting that the government might loosen the central bank's inflation target next year, to 5-5.5% from 4.5%. This might allow official interest rates to be cut faster, but at the expense of higher inflationary expectations. However, this week Mr Palocci insisted that this would not happen.

More worrying would be a deviation from the fiscal discipline that underpins Brazil's ability to pay its debts. Lula has unnerved markets lately by offering large, unbudgeted pay rises to civil servants who are threatening to strike and extra money to settle landless people who have invaded private property in the countryside. Lula must now decide by how much to raise the official minimum wage, to which publicly

financed pensions are linked.

With economic growth expected to average 3% or so in the foreseeable future, “there is no room to loosen fiscal policy,” says Lisa Schineller of Standard & Poor's, a rating agency. She thinks the government will keep to its primary-surplus target by cutting spending in other areas. But the giveaways may come at the expense of investment and social spending, which will constrain future growth.

Brazil is more creditworthy, and less vulnerable to market whims, than a few years ago. In 2001, it needed $56 billion in foreign capital to cover its current-account deficit and amortisation of its debt, notes Rodrigo Azevedo, an economist at CSFB in São Paulo. Thanks partly to an export boom, that gap is likely to narrow to $36 billion this year. This is especially important for the private sector, which accounts for a lot of Brazil's external debt. The share of government debt linked to the dollar has fallen (from 21% to 17%). Because trade has increased as a share of GDP, Brazil could if necessary earn more export dollars for a given depreciation of the *real*.

So a rise in American interest rates, when it comes, will cause less havoc than it would have done. The bigger question is whether Lula will keep his nerve.

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Japan's economy

The final piece

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Are consumers about to jump in and complete the recovery?

Get article background

AP

Blossoming

IN THE 14 years since Japan's economy fell apart, every attempt to piece together a recovery has failed. There is growing optimism, however, that this time is different. Although plenty of gaps remain—from the property market to corporate borrowing—each piece of good news adds to the image of a real rebound. However, one last gaping hole in an otherwise happy economic picture remains: Japan's cautious household sector, which has until recently showed few signs of spending more freely. So onlookers are understandably thrilled by the latest hints, however tentative, that this last, crucial piece may now be falling into place.

Measures of Japanese consumer spending tend to be both unreliable and volatile, so it is best not to get carried away by a couple of good months. Because 2004 is a leap year, with five Sundays in February, early spending patterns are harder to gauge than usual. Nevertheless, there has been plenty of good news. Overall household spending was up by 5.2%, year-on-year, in February, and year-on-year retail sales rose by 0.9%. Retailers such as Aeon and Ito-Yokado are boasting bumper profits. As Japan's tourists prepare for the annual “golden week” holiday in early May, they seem far more eager to travel abroad than they did this time last year.

Surveys also show encouraging trends. In a recent poll of retailers and other service providers by the *Nikkei*, Japan's biggest business newspaper, more firms reported rising than falling demand for the first time in eight years. In Tokyo (where, admittedly, people are cheerier than in the rest of the country) a government survey of consumer sentiment rose in March for the third month in a row. Even officials are starting to sound giddy, by their modest standards. Last month, the government suggested that consumer spending is “picking up”. This week, in explaining the Bank of Japan's growing optimism, Toshihiko Fukui, its governor, declared that spending is “edging higher”.

Do not be underwhelmed by such cautious statements. There are two good reasons to get excited about even faint signs of consumer optimism. One is that, if consumers do decide to spend more freely, all the main elements of a durable economic recovery will at last be at hand. The other is that, with so much else going right for the economy, there is a good chance that consumers will grow more confident. So it would not be surprising if these initial flickers were the first signs of a true consumer revival.

The current recovery began to take shape when Japan's big manufacturers combined deep cost cuts and rapidly growing exports to China, America and elsewhere to boost their profits, which have grown impressively in the past two years. Because many of the biggest companies have also reduced their debt loads sharply over the past few years, they feel comfortable funnelling those profits into fresh capital spending. The resulting demand for machinery, materials and other inputs has in turn boosted demand at other Japanese firms.

Further bits of corporate Japan are now beginning to join in. According to the most recent Tankan survey, the best gauge of Japanese business sentiment, the initial optimism of big manufacturers has now spread dramatically throughout the corporate sector. Not only are small and mid-sized manufacturers feeling cheerier, but so are non-manufacturing companies such as property developers and retailers. Even the

banks are doing much better, despite obvious risks: this week it emerged that bad loans at UFJ, the fourth-biggest bank, were bigger than advertised.

The outlines of a broad-based recovery, therefore, are becoming clearer. Most economists now expect strong growth in both exports and domestic demand to extend into 2005, allowing the economy to keep expanding even as government spending on public works shrinks. Peter Morgan, an economist at HSBC in Tokyo, wrote recently that as long as these trends continue, it is only a matter of time before domestic demand is able to grow without leaning so much on exports.

For the time being, many Japanese consumers are still focused on threats to their finances. The government is deeply in debt, raising doubts about future social-security benefits; the value of residential property is still falling; and they still worry about further job losses (unemployment has come down only slightly in recent months, to 5.0%). Tellingly, although the stockmarket has risen sharply over the past year, foreign investors have done much of the buying. Nevertheless, there is a good chance that Japan's consumers will grow more confident that, this time, the recovery is real. If they decide to join in, they will complete a pretty picture indeed.

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Private equity

Barbarians at the stockmarket

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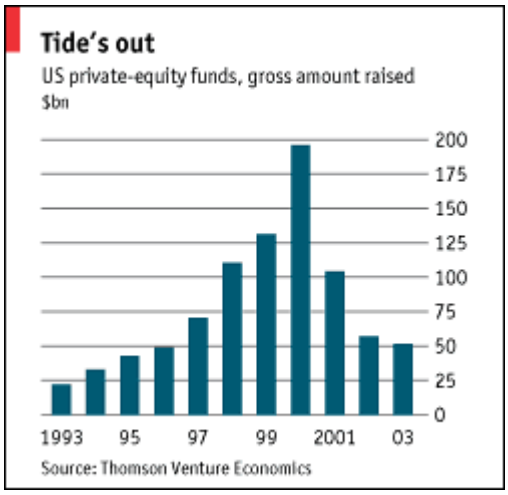
Public offerings are all the rage for private-equity firms

THE world of private equity is looking less private. On April 6th Apollo Group, a New York private-equity firm, raised $930m for its first publicly listed fund. Since then, several other top-notch buy-out shops, including Kohlberg Kravis Roberts (KKR), Blackstone, Kelso and Evercore, have submitted filings for initial public offerings to the Securities and Exchange Commission. More are expected to follow. “We're in conversations with three-quarters of the private-equity world,” crows one Wall Street banker, dreaming of underwriting fees.

The idea is not new. The private-equity firms are setting up listed “business development companies” (BDCs). In essence, these are investment funds that are exempt from corporate taxes as long as they distribute the bulk of profits to shareholders as dividends and meet certain other requirements. American law has long allowed them to be publicly listed. Allied Capital, the oldest and biggest such company in America, went public as long ago as 1960.

Until now most private-equity firms have preferred to raise cash from private sources—pension funds, endowments and the like. Largely, this is because they are keen to avoid the regulatory restrictions that are the price of access to the public markets. However, the flow from the usual sources has slowed sharply in recent years (see chart), even though the amount invested in other “alternative” vehicles, such as hedge funds, has been on the rise.



In addition, the private-equity industry has matured since its beginnings in the 1970s. “It's not as easy as it was to hit home runs, especially for bigger funds,” says a partner at a leading firm. Funds, he adds, rely increasingly on fees. And the pressure on private-equity firms to disclose more about their business has risen as they have taken more money from public pension funds. So setting up a BDC, with its stricter disclosure requirements, is not the drastic step it would once have been.

Over the years many leading private-equity firms have developed “families” of funds rather than general pots of cash. The Carlyle Group, for instance, encompasses not only a buy-out fund, but also venture capital, real estate, mezzanine loans and a fund focused on Asia. Bain Capital boasts buy-out, venture-capital and hedge funds.

So adding another lot of money raised from the public looks attractive—especially in light of the fees. As the investment manager, Apollo will pocket 2% of “gross assets” of the newly listed *BDC*—that is, 2% not only of the $930m raised but also of any borrowed funds, even if this money sits idly in a bank account waiting to be invested. Most of the investment fund's expenses will be paid out of a separate charge to shareholders. Apollo has retained the normal incentive fee (“carry”) of a traditional buy-out fund: essentially, 20% of net profits above a hurdle rate. Allied Capital, in contrast, charges no carry and pays its expenses out of its management fees.

None of this seems to have deterred investors. With interest rates so low, many of them are keen on anything that offers the prospect of a decent yield, from emerging-market bonds to technology companies to BDCs, which are obliged by law to distribute at least 90% of their net profits to shareholders.

Apollo and almost every other private-equity house planning a BDC intend to make loans, both senior and mezzanine (basically, high-yield), to smallish companies. They also have the option of making other bets—in distressed debt, equity and so forth—with 30% of the fund. This niche has been ignored by big banks, which have been increasingly concentrating on lending to larger companies.

The potential returns sound great: Allied Capital claims to have a 15% yield on its $3.1 billion debt portfolio. But sceptics wonder whether there is enough demand in the market to meet the surge in supply. They also believe that some buy-out firms are relying on their brand names, not on experience; KKR, for instance, has no track record in middle-market lending. Thomas H. Lee, another private-equity firm rumoured to be close to filing for a BDC, launched a mezzanine fund in the 1980s that imploded. “It is unclear that investing in buy-outs worth billions of dollars has the same skill set as making $50m loans,” says a banker. Allied Capital and American Capital Strategies, another long-established BDC, each has over 100 employees dedicated to middle-market lending.

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Insuring the Olympics

Uncovered

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If the games are disrupted, the Greeks will be begging Zeus for cash

THIS year's Olympics are a test for the nerves of insurance underwriters. The opening ceremony in Athens is just four months away, and omens are bad. Greek construction workers, when they are not on strike, are scrambling to finish the Olympic stadium. The tram system is still a work in progress; the swimming pool will not have a roof. Then there are the ubiquitous worries about terrorism and security arrangements.

The International Olympic Committee (IOC) has been shopping for a cancellation and disruption policy covering Athens and subsequent games. David Bruce, an underwriter at Hiscox, a syndicate at Lloyd's of London, says they are sure to get it done in time (but not with him, because he already has a lot of Olympics risk). He estimates that total coverage for the Olympics—including broadcasters, advertisers, sponsors and so forth, as well as the IOC—will run to between $500m and $1 billion.

Should anything go wrong, the local organisers of the games look most exposed. The Athens Olympic Committee has not sought cancellation and disruption insurance: it says that its €650m ($775m) security effort, complete with NATO troops, will be enough. So the Greek government would take the brunt of any loss. In contrast, the organising committee in Salt Lake City, host of the winter Olympics in 2002, bought insurance through Lloyd's, says Kelly Flint, then the committee's legal counsel. Fortunately it had booked most policies years in advance, so the terrorist attacks on September 11th 2001 had no effect on premiums.

The thought of terrorism (which has afflicted the Olympics before) is rattling plenty of businesses, from broadcasters to tour operators. One area of concern is the cluster of cruise ships expected to dock at the port of Piraeus to provide accommodation for athletes and rich visitors. Holland America, a cruise line that is sending two ships, has put off its final decisions on insurance until May, when its security experts, along with underwriters, will travel to Athens to check on progress.

Earlier this year the International Group of Protection & Indemnity Clubs, a mutual organisation that provides insurance for almost all the world's ships, dropped its maximum war-risk coverage for Athens-bound vessels from $400m to $50m per ship owing to security concerns. (Ships also have other sources of insurance.) Underwriters and shipowners may be saving the champagne for the closing ceremonies.

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Wall Street's trials

Mixed opinions

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Judges offer different rulings on the harm caused by investment research

A YEAR has passed since Wall Street firms settled with Eliot Spitzer, New York state's attorney-general, and other regulators, over conflicts of interest in their equity research. Enormous sums of money are still at stake, in lawsuits brought on behalf of private investors. It seems that winning and losing may come down to which judge is assigned to each case.

So far, Merrill Lynch seems to have hit the jackpot. All the litigation against it has been consolidated in New York under Milton Pollack, a federal judge who believes that there is no case to answer. Others have been less lucky: Lehman Brothers suffered a nasty setback last month when another federal judge in the same judicial district in lower Manhattan, Jed Rakoff, allowed litigation against it to proceed. These are, of course, early days; but because the stakes are so high, defendants on the end of adverse rulings are under great pressure to settle. It may well be that none of the civil cases lasts long enough to be decided by a jury.

In total, 59 suits have been filed against Wall Street firms because of their research opinions, according to NERA Economic Consulting. One-third have been thrown out. Now a second phase of the battle is about to start: appeals from both sides. On April 23rd the first challenges to the Merrill dismissals are due to be filed. These cases will probably come to trial in the summer. On May 10th, arguments will be heard in an appeal by Citigroup against the certification of a class-action suit by investors seeking damages for the favourable opinions on WorldCom of the bank's telecom analyst, Jack Grubman.

In all these cases, the key issue is how different judges view the law, says Lyle Roberts, an attorney with Wilson, Sonsini, Goodrich & Rosati. The facts in most of these cases are clear: investment opinions were offered that turned out to be wrong. There is also a consensus that for plaintiffs to prevail, there must be evidence of fraud, which in turn requires deceit. Allegations have been based largely on internal e-mails in which analysts expressed much less favourable opinions than those they published. However, in a suit that has been allowed to proceed against Robertson Stephens, a now defunct investment bank, the plaintiffs point to comments made about a company by an analyst directly to certain investors.

The area of dispute, says Mr Roberts, is whether investors' losses were caused by wrong or even deceitful research (as Judge Rakoff thinks possible) or by a broad collapse in share prices and companies' business prospects (Judge Pollack's conclusion). Most of the litigation is built upon the theory of “fraud on the market”. This holds that share prices are determined by information in the market and consequently that bad information leads to bad prices. All investors who purchased shares while doubtful research was being published therefore have a potential claim, even if they never saw the research.

Initially, such cases were brought against firms releasing misleading information. In its appeal, Citigroup argues that the theory should not apply to securities analysts. On April 16th the Securities and Exchange Commission submitted a brief to the court opposing this point.

Judge Pollack clearly has little time for the theory. Last summer he threw out cases filed against Merrill based on the recommendations of its internet analyst, Henry Blodget. He accused plaintiffs of attempting to twist securities laws into “cost-free speculators' insurance”. Prices fell, Mr Pollack concluded, when investors “knowingly spun an extremely high-risk, high-stakes wheel of fortune.” *Caveat emptor*. In February, the judge dismissed still more cases concerning Merrill's recommendations of Tyco shares, although in more restrained language.

Because Judge Pollack is a powerful figure on the New York bench, Wall Street had greeted his early Merrill decision as a sign that its troubles might soon be at an end. However, Judge Rakoff is also

influential. In his Lehman case, an analyst publicly praised RealNetworks, a maker of media-playback software, while allegedly telling an institutional client in an e-mail that it “has to be a short big-time.” When the market became aware of what the Lehman analyst “secretly” knew about RealNetworks, the share price fell, Mr Rakoff wrote. That was sufficient to raise legitimate questions about whether Lehman was responsible for investors' losses.

Lehman's only comment on the case is that it continues to believe that the claims against it have no merit. Given the way litigation often works, however, it would be no surprise if negotiations over a settlement had already begun. Hammering out a deal looks like a daunting task. The price of shares in RealNetworks spiked briefly in early 2000 before collapsing in 2001. Investors lost well over $10 billion. Even if the theory of “fraud on the market” holds, could one analyst really have been responsible for that?

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Economics focus

The price of peace

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From The Economist print edition

In the second of a series of articles on the Copenhagen Consensus project*, we look at armed conflicts

IN MANY poor parts of the world, civil wars remain depressingly common. In a new paper for the Copenhagen Consensus project, Paul Collier and Anke Hoeffler of the Centre for the Study of African Economies at Oxford University examine five ways of reducing the dreadful costs of such wars. The policies they consider aim variously to prevent the outbreak of civil wars, limit their duration, or halt their recurrence.

The benefits of such policies can be huge, for the damage caused by civil wars goes far beyond that caused directly by bullets and bombs. According to the authors' detailed study of previous civil wars, the typical conflict lasts for seven years. During that period, the economy grows by 2.2 percentage points a year less than it would have in peacetime. Full economic recovery takes, on average, a decade after war's end. During those years, the total lost output is equivalent to around 105% of the country's pre-war annual GDP. In addition to shrinking the economy, civil wars cause the slice of income wasted on arms and militias to grow, reducing welfare by another 18% of GDP.

The forgone economic output, however, is just the beginning. Health in the country suffers too, far less because of combat casualties than because of forced migrations, which worsen disease, and collapsing health-care systems. Making conservative assumptions about the value of lost years of life, the authors put the average health costs at around $5 billion per conflict.

Civil wars' effects spill over borders, even though the fighting may not. With an average of 2.7 countries bordering each state mired in civil war, economic losses to neighbouring countries (for instance, from reduced trade and foreign investment) typically amount to 115% of their GDP. Neighbouring countries' total output losses, it turns out, are even bigger than those of the country where the war is being fought. In addition, neighbours spend a total of 12% of one year's output on military spending.

With an average of two new civil wars starting every year, the economic costs average some $128 billion a year. Of course, any such figure relies on a welter of assumptions, on limited data, and can be viewed only as a “gross approximation”. Yet it is likely to be conservative, not least because the authors exclude the more diffused global costs of civil wars, such as their roles in helping the spread of HIV/AIDS, in encouraging illegal drug production, and in creating safe havens for international terrorists.

What is the remedy? The first two policies considered by the authors are aimed at reducing the risk of the outbreak of civil war. First, they look at providing additional aid to the poorest countries. For example, increasing aid by 2% of a poor country's GDP per year would, on past form, raise growth by about 0.2 percentage points a year. That would reduce the risks of civil war, creating an expected gain from peace of $16 billion. But the cost would run to $195 billion. This is poor value for money.

How about a more targeted programme? A common problem of poor countries is that natural resources, most often in the form of diamonds, gold and oil, can spark internal strife. If countries could be required to provide a detailed account of how they spend the proceeds, it is thought that rebels will have less reason to try and capture these profits themselves with arms. The cost of this policy is small—mostly in the form of international co-ordination. Yet the authors reckon that the gains in terms of fewer wars are big, in the amount of $89 billion. They caution, however, that this estimate is highly speculative.

Another approach aims to shorten civil wars after they have started by ensuring that commodities from countries engaged in civil wars fetch a much lower price in global markets. The goal is to starve the belligerents of their ability to wage war. The best-known example is the ban on sales of “conflict

diamonds" from Sierra Leone during that country's civil war. The authors reckon that a 10% reduction in prices for "conflict" commodities can produce a $5.9 billion peace dividend.

Since around half of civil wars occur in countries which have had another internal conflict during the previous ten years, the fourth and fifth policies are aimed at preventing a relapse into war. The authors consider the effect of boosting aid in post-conflict countries by 2% of GDP per year for five years in the middle of the decade after war ends. That would cost around $13 billion. But the benefits would average around $31.5 billion. Unsurprisingly, aid that is targeted on at-risk countries gives better value.

Altruism and imperialism

Lastly, the authors look at military intervention to keep civil wars from recurring. External military intervention led by a single country—such as the UN-sanctioned British action in Sierra Leone—appears capable of limiting further violence. Extrapolating from the Sierra Leone example, intervening in around a dozen similar "post-conflict" countries for ten years would cost some $4.8 billion. The gains might amount to nearly $400 billion, by far the biggest pay-off of any of the policies considered.

In purely economic terms, then, military intervention by a foreign power is the most cost-effective of the policies reviewed, and by a wide margin. Many, of course, will regard that as barely relevant: such intervention raises a host of non-economic issues, not least the charge that the intervening powers are behaving like imperialists. On the other hand, people living in desperately poor countries torn apart by strife might sometimes long for the protection of an imperial power.

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* The Copenhagen Consensus project, organised by Denmark's Environmental Assessment Institute with the co-operation of *The Economist*, aims to consider, and to establish priorities among, a series of proposals for advancing global welfare. The initiative was described in our Economics focus of March 6th. That article can be read here, along with other material, including an Economics focus on education, published this week online. A book, "Global Crises, Global Solutions", containing the full set of papers written for the project is forthcoming from Cambridge University Press.

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About sponsorship

Sports anthropology

Take me out to the ballgame

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Luis Ramirez

Ulama, the oldest sport in the world, is still being played in western Mexico

IT IS a strange coincidence that many popular sports played today with a ball, big or small, were first played in the latter half of the 19th century. Only cricket set its rules earlier, in 1788. Basketball was invented in 1891. Other sports had antecedents: soccer, rugby and American football were all formalised in the 1860s and 1870s from what appears to be a common origin, while baseball was standardised around that time, as was golf—though many Scots claim earlier origins. Tennis as we know it today was devised by Major Walter Clopton Wingfield, a British army officer, for the entertainment of guests at his country estate in 1873. Tennis, though, is an exception in that the indoor form of the game was played with formal rules in England and France at least as far back as 1600. But even this is recent compared with *ulama*, a game once played all over Mesoamerica, from the American Southwest to Peru.

The oldest *ulama* court, in the Mexican state of Chiapas, was built around 1500BC, while latex balls used by the Olmecs, farther west, have been carbon-dated to 300-500 years earlier. This is not to say the rules of *ulama* have not changed over the years—ritual sacrifice of the losers is thought to have died out in the 1300s. But, says Manuel Aguilar, a professor at California State University, in Los Angeles, who studies the game, it is unique in having a continual recorded history stretching back almost 4,000 years.

Dr Aguilar and his colleague James Brady have been directing a group of students in Sinaloa, a state in western Mexico. They have started a comprehensive study of *ulama de cadera*, one of three forms of ulama surviving in Sinaloa, which is perhaps the only place where the once-widespread game is still played. Dr Aguilar speculates that this is because Sinaloa was a frontier during the time of the Spanish colonisation of the Americas, when *ulama* was largely eliminated by the intervention of Catholic missionaries who decried its pagan associations.

Ulama is played on a long, narrow court, called a *taste*, which is 60 metres long and only four metres wide. The opposing sides, of five players each, take turns serving the four kilogram rubber ball and thereafter trying to move the ball up the field, hitting it only with the hip or upper thigh, which are protected by special garments. Points are scored if one team fails to return the other's serve across the halfway point of the *taste*, or if the serving team succeeds in getting the ball past the opponent's end line. The first team to score eight points wins.

However, as Dr Aguilar and his colleagues point out in a series of papers forthcoming in the May issue of *Estudios Jaliscienses*, a Mexican journal, the rules of *ulama* are still today in flux, and often not even

understood by the participants. This is why in a match each team brings a *veedor*, an elder who is meant to settle disputes over the rules.

Dr Aguilar, though, is less concerned with the details of the rules of the game, but with its social implications, both in Sinaloa today, and in Mesoamerica generally over the course of *ulama*'s history. While Dr Brady is, by training, an anthropologist, and so directs the team's efforts to compile an ethnography of the present-day game, Dr Aguilar is an art historian. While this may seem an unorthodox pairing, it has allowed them to make some novel insights.

For example, until their recent work, it was believed in academia that *ulama* was only played by men. However, in their detailed questioning of current players, they found that women play the game today, albeit as an exception, because female players are often stigmatised as being too macho. One of their informants is 94 years old and remembers female players from his youth, so the researchers are fairly certain that women have played throughout the 20th century. And Dr Aguilar's analysis of clay figurines, he says, indicates that women played routinely in pre-Columbian times, indeed as far back as 1200BC. This leads Dr Aguilar to speculate that women stopped playing only because of Spanish intervention, and resumed 100-200 years ago.

Another concern of Dr Aguilar's is the balls used to play the game. He says synthetic rubber cannot be used, as there is a strong tradition of using natural rubber. Because natural rubber is now scarce in Mexico, and the process of making a ball takes about 30 hours, the supply of balls is constraining the spread of the game. Indeed, to understand the process better, Dr Brady tried to make several balls together with his students. The process involved smearing hot latex on his hands and arms, allowing it to dry, and then peeling the strips off and wrapping them around the core of the ball until it reaches the requisite size and weight. The traditional process, says Dr Brady, is necessary to give the ball sufficient bounce.

First-hand experience has caused Dr Brady to revise his understanding of the significance of tributes paid in the 16th century to the Aztec empire, when *ulama* balls were used as a de facto currency. Dr Brady thinks that the growing of rubber in the Aztec empire was probably much more extensive than had previously been thought, as was the production of balls, which may have served as the store of value for an entire economic system.

Both Dr Brady and Dr Aguilar have tried to play *ulama* themselves, but Dr Aguilar says that, although some of his graduate students persevered for longer, the bruises he sustained from the heavy ball caused him quickly to abandon playing the game. The same, it seems, cannot be said of the inhabitants of Sinaloa.

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Genetics

Of mice, and not men

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A “virgin birth” in mice

THE natural world, in all its squishy glory and diversity, is home to some remarkable stories of survival and existence. Out there, in the wild, it is not unusual for plants and animals to reproduce without the need for fertilisation by males. Animals such as fleas, lizards, salamanders and fish can achieve what is called “parthenogenesis”, or virgin birth.

For many plants and animals this is a useful strategy. But until now scientists had thought such a thing was impossible in mammals. Fathers remained a necessity. Now Tomohiro Kono at Tokyo University and colleagues report in the journal *Nature* that they have made live mice by parthenogenesis. Their mice developed into adulthood, and the first pup called “Kaguya” went on to reproduce normally.

However, Azim Surani, a developmental biologist at the Wellcome Trust Cancer Research Institute in Cambridge, challenges the accuracy of the term parthenogenesis. What the researchers have done, he explains, is not exactly parthenogenesis although it did not require males. The team, he says, have constructed an embryo from two female genomes: one from an old female egg and one from a young female egg. They have also introduced a mutation to a gene in the genome from the young egg to encourage normal growth in the reconstructed eggs.

Past attempts to create live mice by parthenogenesis, for example by stimulating mature eggs with chemicals, have failed. Although embryos start to develop, they do not survive implantation. The barrier to parthenogenesis in mammals, it seems, is something known as genetic imprinting. In a normal embryo, there are two copies of each chromosome—one from the mother and one from the father. Each has a slightly different chemical imprint which is vital for normal development. This difference only seems to exist in mammals.

Dr Kono's team overcame the problem of differently imprinted genomes by acquiring a second genome from a young egg. In very young eggs all the genetic imprinting has been erased—a state much closer to a paternal genome. The second thing the team did was to introduce a genetic mutation into the genome of the young egg that allowed for the production of a growth factor, a kind of protein, that can only come from the paternal genome but is vital for normal embryonic development. It is this combination of techniques, explains Dr Surani, that allows a viable embryo to be created from a pair of female genomes.

Although genomes from two different individuals were used, it is possible, in theory, that young eggs could be harvested and stored from a mouse and later used with mature eggs from the same mouse, in order to produce offspring that are clones of the original.

For many, though, the novelty about Dr Kono's work is that a mammal has been born without the need for a male at any stage. Even Dolly the sheep, who was produced by cloning via somatic nuclear cell transfer, benefited from a male imprinted genome. The adult cell whose nucleus was transferred into the egg that became Dolly had a male imprinted genome that was inherited at birth and copied to every cell of the donor's body.

Although the technique will probably work in other mammals, it is a difficult procedure. Only 0.6% of the embryos created survived, and it is thought likely that defects in the imprinting process may cause the surviving adults to develop rare diseases later in life. As it is riskier still than cloning, it is unlikely to be applied to humans any day soon. Any improvements in the technique will quite possibly involve modifications to large numbers of genes. Besides being difficult, it would also cross a new ethical boundary: that of modifying the human germline—the genetic material that passes between generations of human beings.

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Medicine

An affair of the heart

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Magnetic-resonance imaging could become even more useful

EVERY year, more than a million X-ray angiograms are performed in the United States alone. These are done in order to look inside people's arteries and figure out whether they are narrowing in a life-threatening manner. The difficulty with this technique is that it requires either the use of contrast agents—which can cause kidney damage—or significant quantities of radiation.

It would be better if such images could be taken with something less damaging, such as magnetic-resonance imaging (MRI). And that is exactly what Robert Judd and his colleagues at Duke University, in North Carolina, think they have done. In the May issue of the journal *Nature Medicine*, they explain that they have found a way of using MRI to make movies of blood travelling through vessels in the human body.

MRI employs magnetic fields and radio signals to generate its pictures. Atomic nuclei, particularly the single-proton nuclei of hydrogen atoms, are made to line up in the same direction by a strong magnetic field. A pulse of radio waves is then used to perturb this alignment, causing the nuclei to give off radio waves of their own. The radio signal sent back by a tissue thus depends on the chemical composition of that tissue, and since different tissues have different compositions, the application of sufficient computing power can turn the signal into a picture.

Normally, MRI is applied to static tissues. The imager takes pictures of thin slices of body, and these slices are “glued” together electronically. In Dr Judd's technique, by contrast, the imager stays still and the tissue (blood, even though liquid, counts as a bodily tissue) does the moving. By using a series of radio pulses sent out at intervals of a few milliseconds, a moving picture known as a cine-angiogram can be built up frame by frame.

With this technique, says Dr Judd, it is possible to see the anatomy of vessels, and to work out the rate of blood flow. That is useful information for doctors attempting to predict whether a constricted vessel is likely to present a problem.

The team is still developing the technique. In particular, it is trying to improve the clarity of the images. But things look promising—and if it can be made to work routinely, it could be applied easily to existing MRI machines. All that would be required is a change of software.

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Climate change

Plumbing the depths

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Ancient plumbing warns that all is not well with rising sea levels

FEARS that global warming is causing sea levels to rise are one of the main concerns about climate change. But prior to the 19th century, when measurements began, little was known about trends in sea level. Now Dorit Sivan, of the University of Haifa in Israel, and his colleagues may have changed all that with their study of ancient plumbing.

In a paper soon to be published in the journal *Earth and Planetary Science Letters* the team describe evidence from abandoned wells in the ancient Mediterranean town of Caesarea that sheds light on 2,000 years of sea-level trends.

Caesarea, a coastal settlement 25km (15 miles) south of Haifa, was built by King Herod of Judea around 15BC. The city enjoyed a period of nearly 1,300 years of continuous occupation, until it was razed to the ground in 1265. Archaeological excavations have uncovered more than 60 wells that would have provided fresh water for its inhabitants throughout the period of occupation.

By establishing the depth to which each of these differently aged wells was dug, the researchers have reconstructed past sea levels. Excavation of the base of each well revealed pottery shards in the lowest levels which were used to date the period when that well ceased to be used as a water supply and became a household rubbish bin. Excavation also allowed the elevation of a well's base to be measured. This work revealed that new wells had been built throughout the period of habitation. The design of the wells meant that once they had been dug it was difficult to alter their level, so new wells would have been built as conditions changed.

So what makes a “good” well? Obvious as it may seem, a well should be a reliable source of fresh water even at times when the water table is low. In addition, if it is near the coast, it needs to be able to keep out salt water even when there are strong on-shore winds or high tides trying to push it there. The researchers reckoned that this required a depth of 30-40cm of potable water in a well in all conditions. They were thus able to estimate the minimum level of the water table at the time that the excavated wells were in use.

To use this information to work out the sea level, it is necessary to establish a link between the water table at Caesarea and the level of the Mediterranean Sea. From continuous measurements of the water level in one of the ancient domestic wells, the team found a good correspondence between the well-water level and the Mediterranean's level, with the water table about 80cm above sea level.

The results indicate that the sea level has remained reasonably constant over the past 2,000 years. This is in contrast to precise tide-gauge measurements recorded for the past century from around the globe, which have led the Intergovernmental Panel on Climate Change to conclude that sea level has been rising by at least 1mm per year. If this rate of change is extrapolated back, the sea level when Caesarea was abandoned should have been about 1.5 metres lower than today, and 2-3 metres lower than when it was built. Data from the Caesarean wells show that this is not the case, which means that the rise in sea level detected in the 20th century is a recent phenomenon.

Just how recent remains to be established. But Caesarea's Roman plumbing suggests that the oceans are now encroaching on to the land at a pace not seen since the end of the last ice age.

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Astronomy

Dark side of the moon

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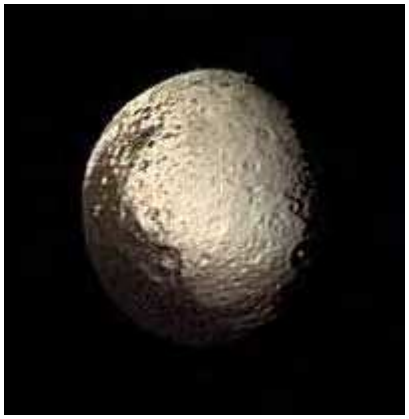
One of Saturn's moons is particularly dark on one side

NASA



Is there anyone out there?

IN THE science-fiction classic “2001”, a spacecraft is dispatched to examine Iapetus, Saturn's third-largest moon, because of an anomalous signal sent from Earth's moon to Iapetus. In the book, as in reality, there is something else odd about Iapetus: unlike any other object in the solar system, one-half of its surface is ten times darker than the other. Arthur Clarke speculated that it was a signal from an alien civilisation. Astronomers naturally tend to doubt that explanation but have had difficulty coming up with a better one.

In this week's issue of *Science*, Gregory Black of the University of Virginia, and his colleagues, present some additional evidence that might help explain the mystery. Because direct observations of Iapetus have been inconclusive, Dr Black sought, like the fictional scientists in the film, to send an emissary to Iapetus. However, Dr Black's emissary was rather cheaper than a spacecraft. He sent a radar signal from the Arecibo radio telescope in Puerto Rico—the world's largest telescope at 305 metres in diameter. By analysing how that signal bounced off both sides of Iapetus, Dr Black gained a little insight into what might be causing the anomalous difference in brightness.

It turns out that the two sides look rather similar to the radar, and about the same amount of signal bounced off either side. This, says Dr Black, means that whatever the dark material is, it is either electrically non-absorbing, or placed in a very thin layer, only a few centimetres thick. Though astronomers are fairly certain that Iapetus is mostly made of water, they are unsure of what else is there. The radar results point towards ammonia as a likely component, because it absorbs radar signals. But it may lie just below the surface.

The radar data still leave much to be explained. But *Cassini*, an unmanned American spaceprobe, is due to arrive at Saturn on July 1st. Its four-year mission is planned to include a close approach to Iapetus. So even if the scheduled date of 2001 has now passed, a definite answer should come soon.

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About sponsorship

Bob Woodward on Iraq

All another president's men

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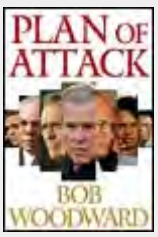
AP

More than 30 years after the Watergate scandal Bob Woodward still has the power to open up the inner workings of the White House

MANY questions are being asked about the decision to invade Iraq last year. Was George Bush unhealthily obsessed by Saddam Hussein? Were plans for war drawn up suspiciously early? Was the intelligence about Iraqi weapons of mass destruction knowingly distorted? Was Colin Powell, the secretary of state, opposed to the invasion? Was Dick Cheney, the vice-president, guilty of inventing links between the Iraqi regime and al-Qaeda? All these, though, are overshadowed by another, even bigger puzzle: why would so many people at the very top of American government, defence and intelligence agencies talk to Bob Woodward, so soon after the invasion itself?

Plan of Attack
By Bob Woodward



Simon & Schuster; 467 pages; $28 and £18.99

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Mr Woodward has taken on an extraordinary role, a mixture of instant historian and father confessor. That is surprising enough given that he is a journalist, for who, after all, trusts that breed? It is even more surprising, given that his fame was made as the co-destroyer of Richard Nixon in the early 1970s, when with Carl Bernstein he revealed the Watergate scandal in the paper that employs him, the *Washington Post*, and later wrote “All the President's Men”. But perhaps the most remarkable thing is that he has made the role bipartisan, having achieved similar access to Bill Clinton's senior team when he wrote “The Agenda” in 1994.

One explanation could be that he has made himself safe, an unthreatening ear in which to whisper. That would be unfair, however, if it were interpreted to mean that he is bland or pulls punches, for he doesn't—although his books are narratives rather than plugs for any personal political line. The likelier reason comes in two parts: that Mr Woodward's record now, over 30 years and 11 previous books, has made it unsafe not to talk to him, for others surely will; and that he is an example of how journalistic experience does count and reassure, given his work on previous White Houses, the CIA and earlier periods involving some of the same officials.

Readers also need that reassurance. “Plan of Attack”, like many of Mr Woodward's previous books, is a gripping read, partly because it tells a fascinating tale, that of the inside story of the preparations to invade Iraq, from 2001 until the war's official end in May 2003, but also because it relies heavily on

invented dialogue, allowing the book to flow like a novel. But is it then fact or fiction? Some of the dialogue comes from minutes or from interviewees' diaries and recollections, but most of it is reconstructed. It is only in the hands of a man with Mr Woodward's reputation, and one able to interview more than 75 senior politicians, officials, intelligence agents and soldiers, that such a technique can really be credible.

Future historians will debate whether it actually is. For the moment, what Mr Woodward writes certainly feels believable, just as did his account of the war in Afghanistan, “Bush at War”, published in 2002. When your reviewer visited Saudi Arabia in January 2003, he spotted copies of that book in the offices of almost every prince and minister he visited, such was the hunger to understand the Bush administration and what it might do next.

The planning for an invasion of Iraq did start soon after September 11th 2001, Mr Woodward says, but his account feels unscandalous: preparing plans is very different from making a decision, but a necessary precursor to doing so. The administration comes across as divided along familiar lines, with Mr Powell and the State Department reluctant warriors. Such splits are not at all surprising; any organisation making weighty decisions in hugely uncertain circumstances would expect—perhaps even welcome—differences of opinion of that sort.

Although the book is rich with anecdotes about CIA activities in Iraq and about war-planning, there is no smoking gun in the metaphorical sense. George Bush emerges fairly well, as an idealist willing to risk his presidency. So does Britain's Tony Blair. Mr Powell comes across as troubled but dutiful. The generals do their best in a typically foggy war, but George Tenet, head of the CIA, looks dreadful over the WMD. The man who comes out worst is Mr Cheney, both as a Machiavellian and as someone determined to believe things for which no evidence existed. He may or may not prove an electoral liability, but he certainly looks like an advisory one.

Plan of Attack.
By Bob Woodward.
Simon & Schuster; 467 pages; $28 and £18.99

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About sponsorship

American foreign policy

Have strategy, need tactics

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Historians' views of the recent past

TOMES on America and its foreign policy are pouring out of publishers about as fast as al-Qaeda tapes seem to arrive at al-Jazeera television studios. Many are written by genuine experts, but they almost all share a problem: that events change too fast for them to stay topical. Bob Woodward avoided that problem (see article) by documenting a finite period, the run-up to the invasion of Iraq. Academics, however, have to deal with it by taking aim at grand strategic principles. But they cannot ignore recent events altogether, and so end up feeling weak when dealing with tactical matters or particular events. That puts them in good company, however: the Bush administration has displayed the same painful gap between good strategy and flawed tactics.

Historians are particularly adept at strategy, for they can draw their principles and lessons from hundreds of years of experience, great swathes of time during which awkward blips and contradictions can be conveniently overlooked. Perhaps the best current user of history as a strategic guide is Niall Ferguson, a Scottish historian now based at New York University who combines a prodigious output with clear, fluent writing and the all-too-rare ability to blend economic analysis with that of politics.

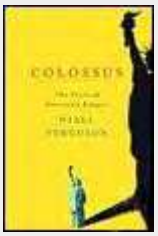
In “Colossus” he seeks to compare America's primacy in today's world with those of previous hegemons and imperialists, most notably Britain, whose empire was the subject of a previous book. Mr Ferguson is a fan both of America and of the idea of empire, not because he wants people to be subjugated but because he thinks there is a liberal form of empire in which an outside force can bring the institutions, practices and rule of law that people need if they are to make prosperous and peaceful use of their own freedom. The British empire did that in the past and America can do so now, he thinks.

This is, of course, both nakedly paternalistic and a somewhat rosy view of Britain's own imperial history. There is, though, a respectable case to be made that it fairly reflects the overall tenor and outcome of several hundred years of British imperial history. The trouble when you apply it to America today, however, is that most critics of the United States are not reacting to the overall tenor and outcome of centuries of imperial history and smoothing over the bumpy bits; they are looking at just a few years, mainly since September 11th, and focusing hard on an especially bumpy bit, namely Iraq.

Mr Ferguson's positive view of American motivations and character are not, therefore, likely to convince many sceptics. Such folk will be more pleased, though, by his pessimism about whether modern America has the will to make imperial interventions work, given the clash between its inward-looking democratic process and the high cost, in both money and casualties, of lengthy interventions overseas. This puts him in the odd position of supporting the invasion of Iraq and expecting that it will all end in tears.

Joseph Nye, a Harvard professor and a former senior Pentagon official during the Clinton administration, is also a supporter of the invasion, but he thinks it was

Colossus: The Price of America's Empire
By Niall Ferguson



The Penguin Press; 384 pages; $25.95. Penguin/Allen Lane; £20

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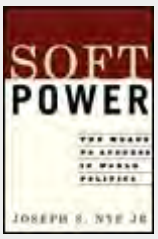
Soft Power: The Means to Success in World Politics
By Joseph S. Nye



PublicAffairs; 191 pages; $25

Buy it at
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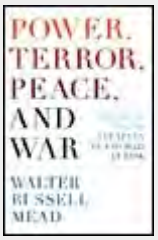
Power, Terror, Peace, and War: America's Grand Strategy in a World at Risk
By Walter Russell Mead

done in the wrong way, and probably at the wrong time. He is more optimistic that a success can still be made of it, but only if America matches with “soft power” what it has already achieved with hard, military power. But what does he mean by “soft power”? Mr Nye invented the phrase in a 1990 book, “Bound to Lead”, and has since found himself pleased that it caught on but constantly needing to explain it. Hence his new book, “Soft Power”, which is a mixture of a general primer on the topic and an appeal for more use of this tool of foreign policy.

In the end, the whole point of “soft” things is that they are indefinable, whereas hard tanks and missiles can be dropped on your foot. What Mr Nye means, roughly, is a blend of diplomacy, public image and culture: making others want what you want. Military power is essential, he says, but many tasks, including nation-building and efforts against nuclear proliferation, need softer techniques too. The Bush administration neglected soft power in the run-up to war, thinks Mr Nye, and is now paying the price.

Walter Russell Mead, a fellow at the Council on Foreign Relations, also thinks power needs careful definition. He, however, finds hard and soft inadequate as distinctions, and prefers to divide it into four: sharp, which means military; sticky, which means economic power, as it both seduces and compels; sweet, which means culture and values; and hegemonic power, which means the ability to set agendas.

Mr Mead is very fond of naming things. His previous book, a 2001 bestseller called “Special Providence”, cast admirable light on the history of American foreign policy by dividing the political and intellectual schools of thought since 1776 into four: Jacksonian, Hamiltonian, Jeffersonian and Wilsonian. Mr Bush has a blend of Jacksonian toughness and Wilsonian idealism, placing him not as an outlier from American history, as many Europeans like to think, but firmly in its tradition.



Knopf; 240 pages; $19.95

Buy it at
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Surprise, Security, and the American Experience
By John Lewis Gaddis

Harvard University Press; 150 pages; $18.95 and £12.95

Buy it at
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In “Power, Terror, Peace, and War”, however, Mr Mead overdoes the effort to define and re-label: as well as his four types of power, four schools of thought and four words in his title, he also names Fordists and millennial capitalists, and American Revivalists who also can be divided into Hamiltonian and Wilsonian groups. The mind boggles, and the point of the book gets lost.

However, for a master-class in how to use history to clarify your thinking the man to turn to is John Lewis Gaddis, a distinguished cold-war historian at Yale. In “Surprise, Security, and the American Experience” he manages to cast brilliant light on how September 11th and its aftermath should be seen in the context of the country's history, and on how the Bush administration's very grand strategy should be understood, but also criticised. And all in a mere 118 pages (plus footnotes).

Colossus: The Price of America's Empire.
By Niall Ferguson.
The Penguin Press; 384 pages; $25.95. Penguin/Allen Lane; £20

Soft Power: The Means to Success in World Politics.
By Joseph S. Nye.
PublicAffairs; 191 pages; $25

Power, Terror, Peace, and War: America's Grand Strategy in a World at Risk.
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About sponsorship

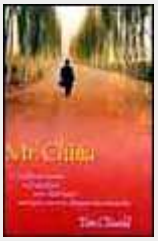
Doing business in China

The perils of Pat

Apr 22nd 2004
From The Economist print edition

SOME time in the early 1990s, Tim Clissold, a Mandarin-speaking Englishman, was hired by a mysterious American—a Wall Street banker known in the book only as Pat—to help him set up a fund for investing hundreds of millions of dollars in China. Unlike conventional joint-ventures, the idea of their unnamed business was simply to provide two things which China sorely needed, capital and management, in return for a healthy, and often a majority, equity stake in local businesses. Mr Clissold does not really explain why he is so vague throughout as to names, dates and the like, but overlooking that rather annoying aspect, the tale he has to tell is hard to put down.

Mr China: A Wall Street Banker, an Englishman, an ex-Red Guard and $418,000,000 Disappearing Day by Day
By Tim Clissold



Constable & Robinson; 304 pages; £9.99 184

Buy it at Amazon.co.uk

Staggering first of all is the sheer ingenuity of the Chinese managers that Mr Clissold and "Pat" managed to select. These were people, after all, who only a few years earlier had started to emerge from the long night of communism. Yet when it came to diverting funds into unapproved businesses, issuing fraudulent letters of credit, setting up competing companies for the purposes of blackmail, manipulating local politicians and, when all else failed, carefully staging acts of violence, these erstwhile communists were highly experienced sharks.

The westerners who suffered at their hands should not be judged too harshly—they were fishing in a very limited pool of private businessmen in a China that was still almost a monolith. But they were perhaps naive in underestimating the extent to which China's law courts and its various government organs would be unwilling and unable to help them.

The book is delightful for the engaging way in which it details the hardships of any businessman who lives on the road—hardships that are multiplied many times when that road happens to be deep in rural China, heading high into the hills where Mao sequestered his factories in order to hide them from the Russians after the Sino-Soviet split. There are endless dances to the Chinese version of "Only You" with embarrassed employees in freezing dance halls. And there are obligatory banquets featuring such local specialities as cow's lungs, ox's forehead, steamed rabbits' ears, a casseroled tortoise and an entire deer's penis.

What pulses through the book, above all, is the author's love of China and of the Chinese people, whose extraordinary vitality is only now being released. Yes, huge mistakes were made and hundreds of millions of dollars were lost. Yes, China's banking sector is "a cock-up of truly astronomical proportions". And yes, joint-ventures were probably never a good way to go. These days, foreign firms get far better results from sole ownership, though that was not a possibility then.

Yet astonishing things have been achieved. The city of Shanghai has been utterly transformed, and development at an astonishing pace has spread far down the length of the Yangzi river, a region encompassing perhaps 300m people. Another 100m live in the booming Guangdong region, in the south. The stock exchanges in Shanghai and Shenzhen are mobilising capital and allocating it with an efficiency that China has never seen before. Even out in horrible, dirt-poor Shanxi, the author concludes, change is coming slowly.

This is a wonderful read for anyone given to *Schadenfreude*, but at the same time it is a useful lesson for those who think there is anything easy about direct investment in brand-new markets.

Mr China: A Wall Street Banker, an Englishman, an ex-Red Guard and $418,000,000 Disappearing Day

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About sponsorship

Samuel Smiles

On the origin of self-help

Apr 22nd 2004
From The Economist print edition

The Victorians' personal coach

THE year 1859 was one of the more remarkable in publishing history. It saw the publication of “On Liberty”, by John Stuart Mill, and “On the Origin of Species”, by Charles Darwin, both of which laid down bold challenges to the assumptions of the day. But it also saw the emergence of another enduring classic: “Self-Help”, by Samuel Smiles, a pragmatic work that did not trouble readers with revolutionary concepts. Needless to say, Smiles's book sold a lot more copies than the other two.

By the time that Smiles died, a century ago this month, a quarter of a million Britons (including Charles Darwin) had bought copies of “Self-Help”. The book was also a bestseller in Italy and Japan. To his great good fortune, Smiles had chanced upon a literary seam that nowadays fills entire bookshop aisles, where it is variously labelled “leadership”, “personal development” or, in unconscious deference to its progenitor, simply “self-help”.

Smiles's idea of self-improvement, however, was different from the torrent of positive-thinking verbiage that dominates the market today. He was raised in the Scottish lowlands and drew from the Calvinism of his surroundings a belief that life was not merely best understood, but also best experienced, as a struggle. Difficulties, he thought, were there to weed out the weak and build what he called “pushing character”. The sort of people Smiles held up as models—the potter Josiah Wedgwood and the engineer George Stephenson were two favourites—epitomised the virtues of doggedness and conviction.

For Smiles, striving was the foundation of society as well as the key to success. Hard-working men (and he nearly always had men in mind) produced good laws and a strong economy. They also limited the damage caused by bad leaders, although an intrusive state might wear down their best qualities over time. “Where men are subjected to over-guidance and over-government,” he wrote, “the inevitable tendency is to render them comparatively helpless.”

This sort of talk has made Smiles a conservative pin-up. A 1986 edition of “Self-Help” had an admiring introduction by Sir Keith Joseph, then Margaret Thatcher's education secretary. But such admirers are obliged to read Smiles selectively. The Victorian moralist was also a radical who believed in universal education and the massive expansion of the franchise. He disapproved of strikes, but only because they harmed the people who participated in them.

Most of all, Smiles loathed those born to wealth and privilege. He regarded the aristocracy, so praised by earlier conduct-book writers, as a bunch of layabouts. Men could, he explained, overcome their coddled origins, but it was a hard and (literally) laborious road that few were likely to take. Had Smiles lived another five years, he would doubtless have applauded the assault on the landed classes led by the Liberal chancellor Lloyd George.

Not surprisingly, middle-class readers lapped him up. But, like other self-help gurus, Smiles probably affected behaviour less than self-perceptions. He set out to tell people that morality and hard work were needed for success. What his readers took from his writing was the reassuring notion that their success must have been the result of morality and hard work.

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Madagascar's natural history

Tales in a twist

Apr 22nd 2004
From The Economist print edition

SET adrift from the African continent 160m years ago, Madagascar has endured long periods of isolation that have led to the evolution of a unique diversity of flora and fauna. Nearly one and a half times the size of California, the world's fourth-largest island boasts over 12,000 plant species, nearly 10,000 of them not found anywhere else, and 346 species of reptile, including 66 varieties of chameleon threatened by a largely illegal international pet trade.

Madagascar is also home to 43 different primates, none better known than the ring-tailed lemur. Alison Jolly came to Madagascar as a postgraduate student in 1963 to study the lemurs' behaviour. On the estate of the aristocratic French de Heaulme family in the south of the island she discovered an untouched forest fragment amid the sisal plantations. Here lemurs and other wildlife showed no fear of the local Tandroy tribesmen who lived a traditional life with the zebu cattle that form the basis of their wealth. In researching the lemurs for over 40 years, Ms Jolly came to know and love both them and the Madagascan people.

In “Lords & Lemurs”, she writes about the primates, the scientists and volunteers who study them, the history of Madagascar, the de Heaulme family and the Tandroy people. In a broad sweep, she ranges from the sometimes vicious territorial disputes between rival lemur troops (described with excitement and, at times, sentimental anthropomorphism), to the history of the mica mines and sisal plantations that drove the island's economy after the second world war.

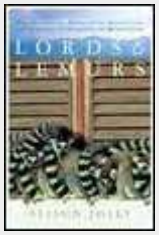
There are intriguing asides along the way, including the story of how the Tandroy tribesmen came to depend on the prickly-pear cactus, introduced on to the island relatively recently, for shelter and protection for their cattle and as a food source in times of hunger. It was the destruction of the prickly pear by the French, through the deliberate introduction of an insect parasite, that brought about the collapse of the Tandroys' traditional way of life, forcing them to migrate and work on the colonial plantations.

Ms Jolly appears torn between writing a general book about the colonial, political and natural history of the country and a deeply personal account of her experiences. While personal anecdotes can enliven the best natural history and historical travelogues, here they too often come across as self-indulgent, detracting from the main issues of the book.

AP

The flora and fauna of Madagascar are celebrated in a very different way in “The Natural History of Madagascar”. This scholarly tome weighs in at over 1,700 pages of detailed analysis from 281 researchers covering the history of scientific exploration, the geology, climate, marine ecology, human ecology and biology of all the main animal and plant groups found on the island. It is a vast and comprehensive work that will be a key reference on the country's biodiversity for many years to come. It

Lords & Lemurs: Mad Scientists, Kings with Spears, and the Survival of Diversity in Madagascar
By Alison Jolly



Houghton Mifflin; 310 pages; $25

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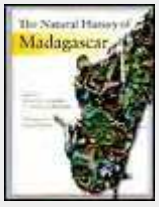
The Natural History of Madagascar



The University of Chicago Press; 1709 pages; $85

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will also stand testament to the future efforts of conservationists to protect the island's unique natural heritage.

Lords & Lemurs: Mad Scientists, Kings with Spears, and the Survival of Diversity in Madagascar.
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Exploration in Africa

Lovers up the Nile

Apr 22nd 2004
From The Economist print edition

FLORENCE BAKER (or Barbara Maria Szasz, as she was born) could well have been one of those European women whose lives were drawn to the east, women whom Lesley Blanch portrayed so romantically in her 1954 bestseller, “The Wilder Shores of Love”. Beautiful, courageous and opinionated, all of them were far too spirited to be kept in stays.

In 1849, Barbara and her *dadus*, her nanny, flee the failed Hungarian revolution and join up with her father, Mathias Szasz, an officer who had pledged allegiance to the Ottoman emperor. The little girl is taken into training in the harem and renamed Florenz. A decade later, she is sold at a white-slave auction in Viddin (in modern-day Bulgaria); the sultan of Viddin is the highest bidder, but she leaves the sale in secret with a man who was in the audience, Samuel Baker, and quickly becomes his mistress.

Baker was one of England's many square-shouldered, tweedy army officers who devoted their lives to the enlargement of the empire. For years his chief passions had been hunting and adventuring. But inspired by John Hanning Speke's discovery of the source of the Nile, and with Florenz's support, he turned to exploration. His exploits, in Egypt and southern Sudan and around the triangle formed by Lake Victoria, Murchison Falls and Ismailia, were less tragically flamboyant than those of Speke. What set him apart from his fellow explorers was the confident presence of Florenz, who by then had anglicised her name to Florence.

To the Heart of the Nile: Lady Florence Baker and the Exploration of Central Africa
By Pat Shipman

William Morrow; 428 pages; $25.95. Published in Britain as "The Stolen Woman: Florence Baker's Extraordinary Life from the Harem to the Heart of Africa"; Bantam Press; £16.99

Buy it at
Amazon.com
Amazon.co.uk

She was all too happy to accompany him on foot or by camel wherever necessary. Queen Victoria refused to receive her, suspecting (rightly) that Florence and Samuel had been lovers before they were married. Nevertheless, social niceties did not deter her. Fluent in Turkish and Arabic, she advised Baker how to negotiate passages and bargain for supplies. Adapting to the climate, she also discarded her long skirts in favour of wide-legged bloomers, rode astride and carried her own shotgun.

Pat Shipman, an anthropology professor at Pennsylvania State University, has written widely, and popularly, about neanderthals and the search for our origins. She is good at recreating the atmosphere of early travel in Africa, but less good on the political ambitions that drove exploration. She knows that her decision to invent dialogue, especially between Baker and his mistress, is not strictly historical, and she makes her defence at the start by quoting Bernard Malamud: “all biography is ultimately fiction.” Well, maybe. But he never said it was of the bodice-ripping variety.

To the Heart of the Nile: Lady Florence Baker and the Exploration of Central Africa.
By Pat Shipman.
William Morrow; 428 pages; $25.95. Published in Britain as “The Stolen Woman: Florence Baker's Extraordinary Life from the Harem to the Heart of Africa”; Bantam Press; £16.99

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Kamisese Mara

Apr 22nd 2004
From The Economist print edition

www.fiji.gov.fj

Ratu Sir Kamisese Mara, Fiji's founding father, died on April 18th, aged 83

Get article background

THE islands of the Fiji archipelago are surely a good approximation of Paradise. Blue waters lap around bays shaded by coconut palms. Jungle-covered hills rise up into a cloudless sky, and dusky maidens proffer bowls of *yaqona*, or kava, to dull the minds of grateful visitors. So the South Pacific has often seemed to Europeans. The more sensible sailed past Fiji, heeding talk of cannibals who did not hesitate to cook missionaries in clay ovens, serve them with wild spinach, and take their own knives and forks to them.

When Europeans grew bolder, they found a land which, though proud of its taste for human flesh, was prouder still of its noble indolence. The first British rulers in the late 19th century, wishing to establish sugar plantations, chose to bring in indentured workers from Calcutta and the Punjab. Though confined to barrack-huts and fed on worm-infested rice, the Indians prospered. By midway through the 20th century, there were more of them than of the Melanesian, Micronesian and Polynesian fusion that made up the ethnic Fijian population. Indians were Fiji's shopkeepers, doctors and civil servants. The races did not mix, but neither did they fight. Mostly, they rubbed along together.

This dual world was the province of Kamisese Mara. For the 30 years in which he dominated Fijian politics, as prime minister and then president, he struggled to keep it a decently multi-racial place. If he sometimes failed, it was because he was too far steeped in the aristocratic customs of his islands. It was hard for him to cede equal *mana*, or power, either to Indian entrepreneurs or to jumped-up johnnies who came from the wrong (western) islands and had been to the wrong schools.

He himself was the hereditary paramount chief (“Ratu”) of Lau, on the archipelago's eastern edge. His wife, the paramount chief of Burebasaga and Rewa, had an even more distinguished ancestry. Together, they held some sway in the islands. As a young man, he briefly studied medicine in New Zealand; but his

great-uncle, intending to groom him as a national leader, made him do history at Wadham College, Oxford. There he narrowly missed a cricket blue, but acquired the impeccable manners that became a world statesman. Perhaps only Ratu Mara could have politely played the cold-war game of sometimes letting American warships into Fijian ports, and sometimes keeping them out; or could have persuaded Fiji's erstwhile friends to give it aid and loans again when, after a coup in 1987, the country found itself in international disgrace.

The coup turned Fiji into a republic, but that was not to Ratu Mara's taste. The islands had been independent since 1970, with himself as their first prime minister, but they remained happily subservient to queen and Commonwealth. Such hereditary power, above the heads of the often fractious local chiefs, was something Ratu Mara understood and esteemed. His own *mana* was important to him. As a paramount chief, he would be greeted with applause not only when he arrived in villages, but also when he belched or farted. Ceremonial whales' teeth, or *tambua*, would be presented to him as marks of loyalty. He became angry when subordinates did not approach him on their knees.

Such a man was imbued with the notion of *taukei*, the Fijian devotion to land-ownership and the spirits of ancestors. Yet when this became the slogan of Fijian nationalists determined to keep land and parliamentary seats out of the hands of Indians, he was uneasy. His own party, the Fijian Alliance, had won elections in 1963, 1968 and 1972 by appealing to Indians as well as Fijians. He himself had walked miles to canvass their votes. He saw this as promoting multi-racial harmony, not as undermining *taukei.*

Yet he also felt that democracy had limits. If Indians and Fijians could compete freely for seats in Parliament, they might come to blows. By this time, there were more Indians than Fijians in the islands. The unwritten understanding that Fijians should rule, while the Indians ran commerce, was under strain.

It was to remain so until the end of Ratu Mara's political life. In 1977 and 1987, the largely Indian National Federation Party won elections. After the first, they failed to form a government, and Ratu Mara was recalled to power. After the second came the republican, nationalist coup that again restored him. In some embarrassment, he went to London the next year to ask the queen whether she would like to be paramount chief of Fiji again.

The leader of the coup, Colonel Sitiveni Rabuka, later claimed to have stormed Parliament at Ratu Mara's behest. Ratu Mara denied it, and sued him; but he certainly lent his weight to a racist constitution, drawn up in 1990, that gave ethnic Fijians a permanent majority of seats in Parliament. Some years later he apologised for it, backing a constitution that allowed free competition for all parliamentary seats.

His finest hour came in 2000, at the height of yet another nationalist coup. Though one of his daughters was held hostage, he refused to suspend the new constitution. The rebels called him the tool of Indian businessmen, and forced him to retire to Lau. After that, he felt his countrymen had rejected him; but as the ethnic wrangling continued, he remained their model of dignified chiefly behaviour.

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Overview

Apr 22nd 2004
From The Economist print edition

In much-anticipated testimony before Congress, Alan Greenspan, chairman of **America's** Federal Reserve, said that the risk of deflation had subsided, that the trend toward lower inflation had ended, and that interest rates "must rise at some point".

Thanks to expectations of higher interest rates, the **dollar** touched $1.18, its highest level against the **euro** in five months. The dollar also rose to ¥109, its highest level against the Japanese currency in more than a month.

America's industrial production fell in March by 0.2%. Factory production was unchanged, while warm weather caused a decline in utilities output. In the year to March, however, industrial production rose by 3.4%.

In the **euro area**, industrial production rose by 0.6% in the year to February. Yet, despite recent upbeat confidence figures, euro-area economies' anaemic growth rates are slowing, according to EuroCOIN, an economic indicator published by Britain's Centre for Economic Policy Research. In March, the indicator fell for the fourth straight month. Consumer-price inflation in the euro area ran at 1.7% in the year to March, up slightly from 1.6% in the year to February.

In February, **France's** current account moved into a surplus of €1.4 billion ($1.8 billion), up from a €0.4 billion deficit in January. Unemployment in France is even higher than previously thought. In February, 9.8% of the workforce was unemployed according to newly revised figures, up from 9.6% in the previous estimate.

In **Sweden**, by contrast, unemployment fell in March to 5.8%, down from 6.0% in February, although the fall in joblessness was less than expected.

Inflation in **Britain** fell to 1.1% in the year to March, the lowest rate since September 2002. Consumer prices, as measured by the CPI, rose by 0.2% in March.

Japan's economic growth is causing trade to surge. The trade surplus rose by 17.8% in the year to March to ¥1.1 trillion ($10.4 billion). Exports surged by 13.3% during the year. Imports rose by 12.2% during the same period, and by 6.5% in March alone, signalling the health of the domestic economy.

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Output, demand and jobs

Apr 22nd 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.0	Q4	+ 5.5	+ 3.9	+ 3.1	– 0.1	Q3	+ 7.3	Q4	5.6	Mar	6.2
Austria	+ 0.8	Q4	+ 0.4	+ 1.6	+ 2.0	+ 3.1	Jan	– 4.8	Jan	4.4	Feb	4.2
Belgium	+ 1.3	Q4	+ 2.7	+ 1.8	+ 2.0	+ 1.2	Feb	+ 0.8	Jan	12.7	Mar†	11.7
Britain	+ 2.7	Q4	+ 3.7	+ 3.2	+ 2.6	– 1.3	Feb	+ 6.5	Feb	4.8	Feb††	5.1
Canada	+ 1.6	Q4	+ 3.8	+ 2.8	+ 3.3	+ 0.5	Jan	+ 1.1	Jan	7.5	Mar	7.4
Denmark	+ 1.0	Q4	+ 2.4	+ 1.8	+ 2.2	– 1.0	Feb	+ 5.3	Feb	6.5	Feb	5.7
France	+ 0.6	Q4	+ 1.8	+ 1.8	+ 2.1	+ 0.9	Feb	+ 2.2	Feb‡	9.8	Feb	9.4
Germany	+ 0.2	Q4	+ 0.9	+ 1.4	+ 1.7	+ 1.8	Feb	– 1.5	Feb	10.4	Mar§	10.6
Italy	+ 0.1	Q4	nil	+ 1.1	+ 1.8	+ 0.2	Feb	– 0.7	Jan	8.5	Jan	8.9
Japan	+ 3.4	Q4	+ 6.4	+ 3.2	+ 2.0	+ 6.9	Feb	+ 0.9	Feb	5.0	Feb	5.3
Netherlands	– 0.4	Q4	+ 1.7	+ 0.9	+ 1.7	– 2.0	Feb	– 3.0	Jan‡	6.4	Mar**	4.7
Spain	+ 2.7	Q4	+ 3.0	+ 2.8	+ 2.9	+ 2.0	Feb	+ 4.4	Feb	11.2	Feb	11.4
Sweden	+ 1.9	Q4	+ 2.2	+ 2.4	+ 2.4	+ 6.2	Feb	+ 7.4	Feb	5.8	Mar†	4.6
Switzerland	nil	Q4	+ 1.8	+ 1.6	+ 1.8	+ 1.7	Q4	+ 3.7	Feb	4.1	Mar†	3.6
United States	+ 4.3	Q4	+ 4.1	+ 4.7	+ 3.6	+ 3.4	Mar	+ 9.1	Feb	5.7	Mar	5.8
Euro area	+ 0.6	Q4	+ 1.2	+ 1.6	+ 2.0	+ 0.6	Feb	+ 0.5	Feb	8.8	Feb	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q4	+ 1.1	na	na	– 3.2	Feb	+ 3.6	Feb	9.5	Mar†	9.9
Greece	+ 5.0	Q4	na	na	na	+ 2.5	Feb	+ 1.3	Dec	na		na
Iceland	+ 4.9	Q4	na	na	na	– 0.3	2002	na		3.6	Feb†	4.1
Ireland	+ 2.7	Q4	na	na	na	+ 3.3	Feb	+ 2.6	Feb	4.6	Mar	4.3
Luxembourg	+ 1.3	2002	na	na	na	– 1.2	Dec	+ 4.1	Nov	4.4	Feb	3.8
New Zealand	+ 3.2	Q4	+ 2.4	na	na	+ 3.2	Q4	+ 6.0	Q4	4.6	Q4	4.9
Norway	+ 0.5	Q4	+ 2.4	na	na	+ 0.2	Feb	+ 2.6	Feb	4.2	Q4	3.7
Portugal	– 0.5	Q4	– 1.0	na	na	– 4.5	Feb	+ 0.6	Feb	6.6	Q4†	6.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Dec-Feb; claimant count rate 2.9% in Mar. §EU harmonised rate 9.3% in Mar. **Jan-Mar.

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Prices and wages

Apr 22nd 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.4	Q4	+ 3.0	+ 2.2	+ 2.6	– 1.1	Q4	+ 1.6	+ 5.9	Q4	+ 3.9
Austria	+ 1.6	Mar	+ 1.8	+ 1.2	+ 1.3	+ 3.0	Mar	+ 2.0	+ 2.2	Feb	+ 2.2
Belgium	+ 1.1	Mar	+ 1.8	+ 1.4	+ 1.5	+ 2.2	Mar	+ 0.8	+ 1.9	Q1	+ 2.4
Britain	+ 1.1	Mar*	+ 1.6	+ 1.5	+ 1.8	+ 1.3	Mar	+ 2.1	+ 3.8	Feb	+ 3.1
Canada	+ 0.7	Mar	+ 4.3	+ 1.5	+ 2.0	– 2.5	Feb	+ 2.8	+ 4.0	Jan	+ 1.8
Denmark	+ 0.7	Mar	+ 2.9	+ 1.4	+ 2.0	+ 0.3	Mar	+ 0.7	+ 3.7	Q4	+ 3.9
France	+ 1.7	Mar	+ 2.6	+ 1.8	+ 1.6	– 0.1	Feb	+ 2.2	+ 2.7	Q4	+ 3.5
Germany	+ 1.1	Mar	+ 1.2	+ 1.1	+ 1.1	+ 0.8	Mar	+ 1.3	+ 1.9	Feb	+ 2.4
Italy	+ 2.3	Mar	+ 2.7	+ 2.1	+ 2.1	nil	Feb	+ 2.8	+ 2.8	Feb	+ 2.2
Japan	nil	Feb	– 0.2	– 0.2	nil	+ 0.2	Mar	– 0.8	+ 2.0	Feb	+ 1.9
Netherlands	+ 1.1	Mar	+ 2.4	+ 1.4	+ 1.3	+ 0.6	Dec	+ 4.2	+ 1.8	Mar	+ 3.2
Spain	+ 2.1	Mar	+ 3.7	+ 2.3	+ 2.4	+ 0.7	Feb	+ 2.9	+ 3.3	Q4	+ 3.9
Sweden	– 0.1	Mar	+ 3.1	+ 0.9	+ 1.7	– 2.3	Feb	+ 0.6	+ 2.7	Dec	+ 4.0
Switzerland	– 0.1	Mar	+ 1.3	+ 0.4	+ 0.8	– 0.1	Mar	+ 0.3	+ 1.8	2002	+ 2.5
United States	+ 1.7	Mar	+ 3.0	+ 1.8	+ 1.8	+ 2.1	Feb	+ 3.3	+ 1.8	Mar	+ 3.2
Euro area	+ 1.7	Mar	+ 2.4	+ 1.7	+ 1.6	nil	Feb	+ 2.6	+ 2.5	Q4	+ 3.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.5	Mar	+ 1.6	na	na	– 0.6	Mar	+ 1.3	+ 3.7	Q4	+ 4.1
Greece	+ 2.7	Mar	+ 4.1	na	na	+ 1.4	Feb	+ 2.7	na		na
Iceland	+ 2.2	Apr	+ 2.3	na	na	+ 2.7	Apr	+ 3.2	+ 3.3	Feb	+ 5.6
Ireland	+ 1.3	Mar	+ 4.9	na	na	– 6.6	Feb	– 7.1	+ 6.1	Q4	+ 6.4
Luxembourg	+ 1.8	Mar	+ 2.7	na	na	+ 0.1	Dec	+ 1.3	– 0.4	Dec	+ 0.7
New Zealand	+ 1.5	Q1	+ 2.5	na	na	– 0.1	Q4	– 1.4	+ 2.3	Q4	+ 2.1
Norway	– 0.6	Mar	+ 3.7	na	na	– 1.1	Mar	+ 9.8	+ 3.9	Q4	+ 5.2
Portugal	+ 2.3	Mar	+ 3.9	na	na	+ 0.3	Mar	+ 2.1	+ 0.8	Feb	– 0.4

*New series. RPI inflation rate in March: 2.6%.

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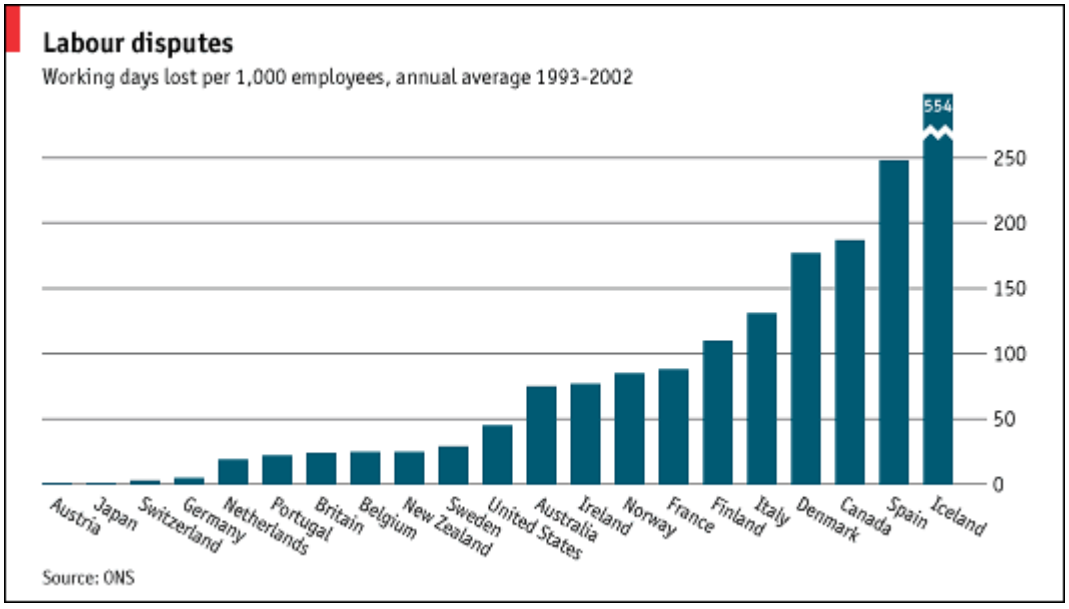
Labour disputes

Apr 22nd 2004
From The Economist print edition



The strike rate—the number of working days lost through labour disputes per 1,000 employees—has fallen in the past ten years. Between 1998 and 2002, it was 13% lower in the OECD than in the previous five years. It declined in industry and construction, but it rose in services. In the European Union, the strike rate fell by 16%, but in the United States it increased by 12%.

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Apr 21st 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.6	+14.0	Feb	5.54	4.80	5.33	5.93	5.38	6.75
Britain	+ 6.8	+ 8.2	Feb	4.34	3.59	4.50	4.97	4.42	5.81
Canada	+10.3	+ 9.4	Feb	1.96	3.24	2.85	4.65	5.11	6.00
Denmark	+ 6.2	+ 6.6	Feb	2.15	2.69	2.50	4.28	4.35	5.45
Japan	+ 4.1	+ 1.9	Mar	0.02	0.02	0.12	1.56	0.63	1.63
Sweden	+ 1.0	+ 4.2	Feb	2.01	3.43	2.82	4.55	4.64	2.96
Switzerland	+11.6	+ 5.1	Mar	0.28	0.31	1.09	2.67	2.51	2.34
United States	+ 7.5	+ 4.5	Mar	1.08	1.22	2.17	4.42	3.99	5.90
Euro area†	+10.7	+ 6.3	Feb	2.07	2.55	2.43	4.11	4.11	3.97

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.22%, Japan No. 259 1.57%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.0%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Apr 22nd 2004
From The Economist print edition

1995=100

	Apr 13th	Apr 20th*	% change on one month	% change on one year
Dollar index				
All items	98.9	99.4	– 0.7	+30.3
Food	97.2	96.6	– 3.9	+23.7
Industrials				
All	101.3	103.4	+ 3.6	+39.6
Nfa†	96.9	97.0	+ 2.3	+22.7
Metals	105.1	108.8	+ 4.5	+55.8
Sterling index				
All items	86.0	87.5	+ 2.3	+14.6
Euro index				
All items	109.3	109.7	+ 2.4	+19.8
Yen index				
All items	112.5	114.5	+ 0.7	+17.7
Gold				
$ per oz	408.00	398.05	– 4.4	+18.9
West Texas Intermediate				
$ per barrel	37.13	37.21	– 0.5	+24.4

* Provisional. † Non-food agriculturals.

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Stockmarkets

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From The Economist print edition

Market indices

	Apr 21st	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,444.7	3,462.9	3,274.9	+ 0.1	– 0.5	+ 4.2	+ 1.4
Austria (ATX)	1,965.1	1,985.9	1,568.9	nil	– 1.1	+27.2	+19.7
Belgium (Bel 20)	2,491.3	2,517.3	2,244.2	+ 0.6	–32.3	+11.0	+ 4.5
Britain (FTSE 100)	4,539.9	4,569.0	4,309.4	+ 1.2	–34.5	+ 1.4	+ 0.4
Canada (Toronto Composite)	8,573.1	8,898.8	8,220.9	– 0.8	–24.7	+ 4.3	– 0.7
Denmark (KBX)	231.9	241.3	219.0	+ 0.4	–23.1	+ 8.6	+ 2.3
France (SBF 250)	2,552.2	2,594.4	2,411.5	nil	–41.9	+ 5.8	– 0.4
(CAC 40)	3,743.2	3,785.4	3,518.5	+ 0.3	–45.9	+ 5.2	– 1.0
Germany (DAX)	4,026.2	4,151.8	3,726.1	+ 0.3	–50.1	+ 1.5	– 4.4
Italy (BCI)	1,326.3	1,333.2	1,239.5	+ 0.4	–39.2	+ 5.5	– 0.7
Japan (Nikkei 225)	11,944.3	12,127.8	10,365.4	– 1.3	–69.3	+11.9	+ 9.8
(Topix)	1,203.6	1,217.9	1,022.6	– 1.2	–58.3	+15.3	+13.2
Netherlands (AEX)	353.9	364.8	326.3	+ 1.1	–49.6	+ 4.8	– 1.4
Spain (Madrid SE)	867.1	881.7	808.3	– 0.6	–24.4	+ 7.3	+ 1.0
Sweden (Affarsvarlden Gen)	210.9	218.1	188.5	+ 0.4	–47.3	+12.0	+ 4.3
Switzerland (Swiss Market)	5,795.1	5,934.4	5,469.0	+ 0.6	–31.1	+ 5.6	– 0.7
United States (DJIA)	10,317.3	10,737.7	10,048.2	– 0.6	–12.0	– 1.3	– 1.3
(S&P 500)	1,124.1	1,157.8	1,091.3	– 0.4	–26.4	+ 1.1	+ 1.1
(NASDAQ Comp)	1,995.6	2,153.8	1,901.8	– 1.4	–60.5	– 0.4	– 0.4
Europe (FTSE Eurotop 300)*	1,012.9	1,026.2	957.9	+ 0.4	–40.6	+ 5.7	– 0.5
Euro area (FTSE Ebloc 100)*	862.6	888.3	815.4	nil	–44.4	+ 3.7	– 2.4
World (MSCI)†	1,052.1	1,085.8	1,025.9	– 0.4	–27.4	+ 1.5	+ 1.5
World bond market (Citigroup)‡	588.1	619.5	588.1	– 0.4	– 5.1	– 2.6	– 2.6

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Apr 22nd 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Apr 21st	year ago	Currency units per $ Apr 21st	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 15.9	Feb	− 30.0	Q4	− 5.2	− 4.6	87.7	79.3	1.36	1.62	2.42	1.63	1.25	0.5
Austria	− 1.1	Jan	− 1.9	Feb	− 0.3	− 0.5	103.4§	101.9	0.84	0.91	1.49	–	0.77	-1.2
Belgium	+ 20.8	Feb	+ 8.0	Dec	+ 4.2	+ 4.1	103.6§	101.8	0.84	0.91	1.49	–	0.77	nil
Britain	− 82.4	Feb	− 30.8	Q4	− 2.5	− 2.6	104.4	99.7	0.56	0.63	–	0.67	0.52	-2.9
Canada	+ 44.4	Feb	+ 18.5	Q4	+ 1.6	+ 1.1	85.3	80.9	1.36	1.45	2.41	1.62	1.24	0.7
Denmark	+ 9.3	Feb	+ 6.3	Feb	+ 2.7	+ 2.7	106.0	105.6	6.27	6.78	11.1	7.47	5.74	1.0
France	+ 2.9	Feb	+ 11.4	Feb	+ 1.2	+ 1.0	107.3§	104.9	0.84	0.91	1.49	–	0.77	-3.7
Germany	+156.7	Feb	+ 55.8	Feb	+ 2.4	+ 2.3	105.1§	102.2	0.84	0.91	1.49	–	0.77	-3.7
Italy	+ 1.2	Jan	− 19.0	Feb	− 1.0	− 1.0	76.5§	74.8	0.84	0.91	1.49	–	0.77	-2.9
Japan	+116.1	Mar	+149.9	Feb	+ 3.2	+ 3.2	136.5	128.8	109	120	194	130	–	-6.8
Netherlands	+ 32.0	Feb	+ 14.4	Q4	+ 2.8	+ 3.0	103.2§	101.1	0.84	0.91	1.49	–	0.77	-2.5
Spain	− 53.5	Jan	− 23.8	Jan	− 2.8	− 2.7	77.5§	76.2	0.84	0.91	1.49	–	0.77	0.2
Sweden	+ 20.1	Feb	+ 18.9	Q4	+ 5.6	+ 5.3	80.5	80.2	7.72	8.33	13.7	9.21	7.07	0.5
Switzerland	+ 7.7	Mar	+ 32.9	Q4	+10.3	+10.1	110.4	114.0	1.32	1.38	2.33	1.57	1.21	na
United States	−556.5	Feb	−540.9	Q4	− 5.1	− 5.0	98.5	107.3	–	–	1.77	1.19	0.92	-5.1
Euro area	+ 88.2	Feb	+ 32.4	Jan	+ 0.5	+ 0.4	89.5	88.1	0.84	0.91	1.49	–	0.77	-2.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.2	Feb	+ 10.4	Feb	na	na	82.7§	80.7	0.83	0.91	1.47	–	0.76	1.9
Greece	− 25.9	Jan	− 11.2	Feb	na	na	59.9§	58.9	0.83	0.91	1.47	–	0.76	-1.6
Iceland	− 0.3	Feb	− 0.6	Q4	na	na	93.1**	94.2	73.5	76.1	130	87.6	67.3	0.2
Ireland	+ 39.8	Jan	− 3.0	Q4	na	na	95.2§	92.4	0.83	0.91	1.47	–	0.76	-1.3
Luxembourg	− 3.5	Jan	+ 2.5	Q4	na	na	103.6§	101.8	0.83	0.91	1.47	–	0.76	-1.8
New Zealand	− 2.2	Feb	− 3.5	Q4	na	na	100.1	97.3	1.58	1.79	2.80	1.88	1.45	2.2
Norway	+ 27.9	Mar	+ 30.1	Jan	na	na	96.9	101.6	6.94	7.17	12.3	8.27	6.36	9.7
Portugal	− 13.9	Jan	− 8.0	Jan	na	na	94.7**	91.7	0.83	0.91	1.47	–	0.76	-3.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, February average. ‡OECD forecast.
**IMF, December average.

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Trade in commercial services

Apr 22nd 2004
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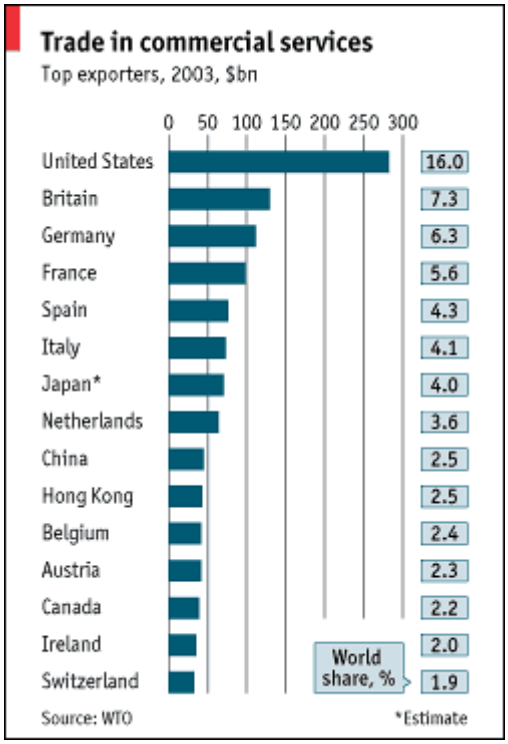

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Overview

Apr 22nd 2004
From The Economist print edition

India moved into a trade surplus in March, its first for two years. Its 12-month deficit narrowed to $15.4 billion.

Poland's economy is booming: industrial production surged by 23.8% in the year to March. Its 12-month trade deficit fell in February to $5.3 billion, only one-third as big as in 2000.

Israel's deflation rate increased to 2.7% in the year to March. It is one of only two countries in the table (the other is Brazil) where GDP contracted during 2003.

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The Economist poll of forecasters

Apr 22nd 2004
From The Economist print edition

Every three months, *The Economist* polls a group of forecasters and averages their predictions for economic growth and current-account balances in 25 emerging economies. Compared with our last poll in January, our seers have become considerably more optimistic about the economic outlook. They have raised their estimates for 2004 GDP growth in 21 out of 25 emerging economies, in some cases substantially. Argentina's economy, for instance, is now expected to grow by 6.9% this year, up from an estimate of 5.1% three months ago. Once again, China is tipped to be the fastest-growing emerging economy tracked in our poll. Our seers now expect China's GDP to rise by 8.9% this year, up from a forecast of 8.5% in January.

April

	Real GDP % change		Current account % of GDP	
	2004	2005	2004	2005
China	8.9	7.8	1.6	1.4
Hong Kong	6.5	4.9	11.6	10.4
India	7.2	7.0	0.1	0.2
Indonesia	4.6	4.4	3.1	2.4
Malaysia	6.1	5.5	9.0	6.9
Philippines	4.1	4.0	2.8	1.9
Singapore	5.9	4.6	23.6	21.3
South Korea	5.4	5.4	2.4	1.9
Taiwan	5.4	4.4	7.0	6.0
Thailand	7.2	6.1	4.1	2.8
Argentina	6.9	3.6	3.8	3.0
Brazil	3.6	3.6	–0.1	–0.5
Chile	4.7	5.0	0.2	–0.7
Colombia	3.9	3.7	–2.3	–2.5
Mexico	3.4	3.4	–2.5	–2.5
Peru	3.9	3.7	–1.1	–1.3
Venezuela	7.8	3.8	8.5	6.9
Egypt	3.2	4.0	0.4	–0.2
Israel	2.4	3.7	–0.2	–0.7
South Africa	2.6	3.3	–1.9	–2.0
Turkey	4.8	4.4	–2.9	–2.5
Czech Republic	3.3	3.9	–5.7	–5.4
Hungary	3.1	3.5	–6.0	–5.2
Poland	4.8	4.7	–2.2	–2.7
Russia	6.6	5.3	5.5	3.2

Sources: ABN Amro; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Financial Markets; J.P.Morgan Chase; Merrill Lynch; Citigroup; UBS Warburg.

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Economy

Apr 22nd 2004
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.7	Q1	+23.2	Feb	+ 3.0	Mar	+18.0	Mar	+35.4	2002	439.8	Mar
Hong Kong	+ 5.0	Q4	– 6.1	Q4	– 2.0	Feb	– 9.8	Feb	+17.4	Q4	123.8	Mar
India	+10.4	Q4	+ 7.4	Feb	+ 4.1	Feb	–15.4	Mar	+ 3.2	Q4	106.1	Mar
Indonesia	+ 4.4	Q4	+ 5.1	Jan	+ 5.1	Mar	+28.7	Feb	+ 7.8	Q3	34.8	Feb
Malaysia	+ 6.4	Q4	+16.7	Jan	+ 1.0	Mar	+21.1	Feb	+12.3	Q4	48.3	Feb
Philippines	+ 4.5	Q4	– 0.2	Jan	+ 3.8	Mar	– 1.8	Feb	+ 3.3	Dec	13.0	Mar
Singapore	+ 7.3	Q1	+38.3	Feb	+ 1.6	Feb	+15.8	Feb	+28.2	Q4	101.2	Feb
South Korea	+ 3.9	Q4	+16.6	Feb	+ 3.1	Mar	+24.0	Mar	+18.4	Feb	163.6	Mar
Taiwan	+ 5.2	Q4	+28.0	Feb	+ 0.9	Mar	+15.3	Mar	+28.6	Q4	226.5	Mar
Thailand	+ 7.8	Q4	+16.4	Feb	+ 2.3	Mar	+ 4.0	Feb	+ 7.9	Feb	41.9	Feb
Argentina	+11.3	Q4	+ 9.7	Feb	+ 2.3	Mar	+14.5	Feb	+ 7.9	Q4	14.9	Mar
Brazil	– 0.1	Q4	+ 1.8	Feb	+ 5.9	Mar	+27.2	Mar	+ 5.0	Feb	52.5	Feb
Chile	+ 3.3	Q4	+ 8.0	Feb	– 0.7	Mar	+ 4.2	Mar	– 0.6	Q4	15.9	Mar
Colombia	+ 4.3	Q4	+ 3.6	Dec	+ 6.2	Mar	+ 0.3	Jan	– 1.4	Q4	11.3	Mar
Mexico	+ 2.0	Q4	+ 2.2	Feb	+ 4.2	Mar	– 6.1	Feb	– 9.2	Q4	63.1	Feb
Peru	+ 4.1	Feb	+ 2.9	Jan	+ 2.8	Mar	+ 1.0	Feb	– 1.1	Q4	9.8	Feb
Venezuela	+ 9.0	Q4	+100.4	Jan	+23.6	Mar	+15.0	Q4	+ 9.6	Q4	17.2	Feb
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Q4	+ 3.9	Q4	13.7	Jan
Israel	– 0.6	Q4	+ 3.0	Jan	– 2.7	Mar	– 5.7	Mar	– 0.2	Q4	26.6	Mar
South Africa	+ 1.5	Q4	– 1.4	Dec	+ 0.7	Feb	+ 1.9	Feb	– 1.5	Q4	8.3	Mar
Turkey	+ 6.1	Q4	+15.6	Feb	+11.8	Mar	–22.5	Jan	– 6.7	Dec	33.3	Feb
Czech Republic	+ 3.1	Q4	+ 7.1	Feb	+ 2.5	Mar	– 2.3	Feb	– 5.7	Q4	27.0	Mar
Hungary	+ 3.6	Q4	+12.3	Feb	+ 6.7	Mar	– 3.7	Feb	– 6.0	Feb	12.3	Mar
Poland	+ 4.7	Q4	+23.8	Mar	+ 1.7	Mar	– 5.3	Feb	– 3.7	Feb	36.3	Feb
Russia	+ 5.7	Q3	+ 6.6	Mar	+10.3	Mar	+60.7	Jan	+35.3	Q1	82.6	Feb
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.7	Q4	+ 7.9	Feb	+ 0.4	Mar	– 2.0	Feb	– 1.2	Q4	1.3	Feb
Latvia	+ 7.4	Q4	+ 8.5	Feb	+ 4.8	Mar	– 2.1	Feb	– 1.0	Feb	1.4	Feb
Lithuania	+10.6	Q4	na		– 1.0	Mar	– 2.8	Feb	– 1.2	Q4	3.2	Feb
Slovakia	+ 4.7	Q4	+ 7.8	Feb	+ 8.2	Mar	– 0.5	Feb	– 0.3	Dec	12.3	Feb
Slovenia	+ 2.5	Q4	– 0.2	Feb	+ 3.5	Mar	– 0.8	Feb‡	nil	Feb	8.6	Jan
Pakistan	+ 5.1	2003†	–13.3	Dec	+ 5.3	Mar	– 1.6	Mar	+ 3.6	Q4†	11.4	Feb
Saudi Arabia	+ 1.0	2002	na		+ 0.4	Feb	+42.6	2002	+11.9	2002	23.9	Jan

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Apr 22nd 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Apr 21st		Dec 31st 2003	
	Apr 21st	year ago	Apr 21st	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.7	2.90	1,731.6	– 2.7	+ 10.4	+ 10.4
Hong Kong	7.80	7.80	13.8	0.20	12,227.3	– 3.5	– 2.8	– 3.2
India	44.0	47.3	78.0	4.37	5,876.4	– 0.5	+ 0.6	+ 4.3
Indonesia	8,651	8,730	15,335	7.55	814.2	+ 4.7	+ 17.7	+ 14.6
Malaysia	3.80	3.80	6.74	3.00	864.0	– 0.3	+ 8.8	+ 8.8
Philippines	55.8	52.5	99.0	8.50	1,537.8	+ 3.7	+ 6.6	+ 6.0
Singapore	1.69	1.78	3.00	0.75	1,848.4	– 1.1	+ 4.8	+ 5.3
South Korea	1,155	1,219	2,048	3.91	930.0	+ 1.5	+ 14.7	+ 18.3
Taiwan	32.9	34.8	58.3	1.10	6,810.3	– 1.0	+ 15.6	+ 19.3
Thailand	39.5	42.8	70.1	1.31	706.7	+ 0.7	– 8.5	– 8.2
Argentina	2.85	2.84	5.05	2.69	1,084.8	– 9.0	+ 1.2	+ 4.1
Brazil	2.93	3.03	5.19	15.87	21,077.6	– 5.5	– 5.2	– 6.7
Chile	608	713	1,077	1.68	7,308.2	– 2.4	– 0.4	– 2.9
Colombia	2,626	2,911	4,655	7.77	3,333.4	– 2.7	+ 42.8	+ 51.2
Mexico	11.3	10.5	20.1	5.91	10,539.4	– 0.7	+ 19.8	+ 19.0
Peru	4.00	3.46	7.09	2.50	2,973.6	– 0.7	+ 22.1	+ 5.7
Venezuela	3,055§	1,598	5,415	11.59	25,855.0	– 1.3	+ 16.4	+ 8.7
Egypt	6.20	5.91	10.98	8.49	15,313.4	+ 0.7	+ 31.6	+ 31.0
Israel	4.57	4.62	8.10	1.00	583.2	+ 1.7	+ 9.1	+ 4.9
South Africa	6.72	7.60	11.9	8.20	10,658.6	– 2.9	+ 2.6	+ 2.0
Turkey	1,383,500	1,615,000	2,452,530	20.00	19,270.4	+ 3.2	+ 3.5	+ 5.1
Czech Republic	27.4	29.0	48.5	2.06	847.4	+ 1.5	+ 28.6	+ 20.6
Hungary	211	224	373	11.84	11,604.1	+ 1.7	+ 23.7	+ 21.8
Poland	4.00	3.90	7.09	5.73	25,158.3	+ 0.6	+ 20.8	+ 13.0
Russia	28.9	31.1	51.2	14.00	696.3‡	– 5.8	+ 21.2	+ 22.8
EMF (MSCI)*	1.00	1.00	1.77	na	476.9	– 2.2	+ 7.7	+ 7.7
EMBI+†	1.00	1.00	1.77	na	291.9	– 2.1	– 1.0	– 1.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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